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THE POLITICAL ECONOMY OF THE BUDGET PROCESS: THE CASE OF VENEZUELA

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The Political Economy of the Budget Process in the Andean Region: The case of Venezuela[1]

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Foreword

During the last decade, most Andean countries implemented a set of fiscal reforms aimed at strengthening public finances, enhance resource allocation and contribute to macroeconomic stability. However, despite recent improvements in fiscal performance, public finances remain vulnerable, fiscal policies have often been pro-cyclical and debt sustainability continues to be a challenge in the region. Although considerable attention has been given to fiscal rules and institutional reform to address some these weaknesses, there is a growing effort to try understand the outcomes of fiscal policies from a political economy perspective.

Understanding the budget process as the arena where decisions regarding the use of public funds take place and society faces constraints and trade-offs regarding the use of its resources is a key ingredient to provide useful recommendations for improving public expenditure management in Latin American, and ultimately increase the sustainability, efficiency, and representativeness of public expenditures.

This study presents the case of Venezuela. The report describes the main actors (formal and informal) involved in the budget-making process, and presents evidence regarding the main political and economic determinants of fiscal performance. It also discusses whether different political and institutional arrangements governing the budget process affect incentives for the composition of the budget.

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This project complements other recent efforts in this field : (i) the Budget Practices and Procedures Survey, launched by the OECD and the World Bank with the support of the IADB, and (ii) other IADB initiatives like the 2006 Social and Economic Progress Report (IPES) "Understanding the Politics of Policies", and the Research Network Project "Political Institutions, Policymaking Processes, and Policy Outcomes" (PMP).

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Table of Contents

Introduction……………………………………………………………………………………......1

I. Theoretical Framework ………………………………………………………………...………….3

II. The political economy of the oil rent model and the budget making in Venezuela………...………3

III. Characterisation of the budget outcomes…………………………...…………….……....…5

IV. Characteristics of political institutions, actors and policy-making process ..……….…….……......10

V. The budget-making process ...……………………………………………………......…..…14

VI. Budget amendments in the approval and implementation stage: and empirical assessment..…….33

VII. Econometric Evidence …...………………………………………………………….....….55

Conclusions ……………………………………………………………………………….....…59

Bibliography ……………………………………………………………………………...……62

Annexes ……………………………………………………………………………………......66

Introduction

Venezuela, along with other countries in Latin America, suffered a severe fiscal contraction during the period 1974-1999. Public spending measured as a share of GDP fell from 35% in 1974 to less than 24% in 1999, a proportion that is equivalent to the percentages registered in the seventies prior to the oil shock of 1973-74. The decline in per-capita terms was even more drastic, equivalent to 23% in the decade of the 1990s alone. In contrast, during the period 1999-2004 the public spending grew significantly, representing 34% of the GDP in 2004, a level equivalent to the percentage registered during the oils shocks of 1970s.

During the same period the emergence of large fiscal deficits was notable, leading to the rapid accumulation of public debt. Venezuela's debt growth has been one of the highest in Latin America. Paradoxically, it increased significantly between two oil booms, rising from 9% of GDP in 1970 to more than 30% in 2004. Similarly, since the 1990s debt servicing has appeared as an important component of the public budget (around 24 % of total spending).

In addition, several measures and studies point to important problems in terms of budget outcomes. In this regard, there are doubts about the sustainability of public finances and also important issues regarding expenditure efficiency in several areas of public action. Moreover, there is evidence that fiscal policy lacks flexibility, and using several indicators, the budget process seems to have little representativeness. Consequently, the bases of Venezuelan budgets have become encumbered with programmes which are unsustainable, non-adaptable, inefficient (they divert resources from high to low value uses), inequitable/regressive (they redistribute income from lower to higher income groups), and the allocation of resources tend to reflect the preferences of interest groups.

It is also possible to observe larger changes in the budget composition over time and frequent adjustments in the allocations of public expenditure in response to political and economic changes. In the first part of 1999, for example, the budget suffered seven different adjustments[2] equivalent to 1.5% of GDP. Inconsistently, at the same time the government increased spending on salaries within the public sector, in universities, and for pensioners by the same amount of 1.5% of GDP.

These facts give rise to a number of questions: how is it possible to explain such variations in the level and composition of the budget across time? Are these changes associated only with variations in the main economic variables? What are the political and economic determinants of budget (re) allocations and fiscal performance? Who makes budgetary policy in Venezuela? What is the role of different actors and institutions in explaining budget outcomes?

This study seeks to respond to these questions and to provide an analysis based on positive and empirical approaches to the budget-making process in Venezuela from 1974 to 2004 in order to understand budget expenditure decisions, and to analyse the actors and forces which affect the outcome. It will tackle the following tasks:

- Analyze the main actors (formal and informal) involved in the budget-making process and explain how they shape this process[3]. Three different actors will be analysed: the Executive, the Congress, and the different economic and political interest groups that influence budget allocations in the Executive-Legislative process.

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[2] These adjustments were made as a consequence of new oil prices which decreased from 15.5 $/b to 9 US$/b.

[3] In a democracy, many individuals and groups are involved in the design and adoption of different public expenditure programmes. Debate over which group determines the level and type of public expenditure is commonplace. Elected officials, bureaucrats, and interest groups have all been suggested as the primary figures in determining public expenditures.

- Present econometric evidence about the main political and economic determinants of fiscal performance.
- Discuss whether different political and institutional arrangements governing the budget process affect incentives for the composition of the budget, and how this occurs.

Two studies comprise the main basis over which this study relies for the analysis of the policy making process and the budget process in Venezuela. The first and most relevant is the PhD dissertation "The Political Economy of the Budget-Making Process in Venezuela, 1974-1999" (Puente, 2005); the second, is the study "Political Institutions, Policymaking Processes, and Policy Outcomes in Venezuela", (Monaldi et al, 2005).

A large amount of quantitative data is used, covering a period of 30 years (1974-2004). This information is utilized to measure changes in specific levels of budget (proposed, approved and executed), years, programmes and areas of the budget. This database is also the main resource for several econometric exercises. A variety of interviews with policy makers and politicians were conducted to explore the role of different actors and the functioning of formal and informal procedures in the budget making process.

It is possible to identify four main findings in this study. Firstly, from the general policymaking as well as budget-making perspective, three distinctive sub-periods within the years 1974-2004 were identified from both a qualitative as well as quantitative approach, displaying the following main characteristics: First period (1974-1988), was mainly characterized by the effects of the first oil boom and displayed a period of strong Presidential power within a cooperative system strongly influenced by a corporative arrangement in a limited political competitive context. Second period (1989-1999), was marked by the decline in oil revenues, and as presidential power weakened Congress' greater power became evident despite the prevailing non-cooperative system and fragmented political context. Third period (1999-2004), was typified as a period of increased polarization and constitutional reform, which provided the basis for a constitutional and informally powerful President with no political competition.

Secondly, in general the Executive branch is the leading actor in the budget-making process. The Executive has a number of bargaining advantages over Congress during the process. However, budget allocations are also the product of legislators' pursuit of (re) election and power, as well as the demand of interest groups. Thirdly, besides fundamental economic variables, such as oil income, macroeconomic adjustment programmes and others; it is found that political variables such as electoral year, the power of the Executive vis-à-vis Legislative among others, are important determinants of budget (re) allocations and fiscal performance. Fourthly, as has been shown by the political economy literature, political institutions affect the 'rules of the game' under which different actors interact, by placing constraints on the whole budgetary process and distributing power and responsibilities among different actors.

The study is structured as follows: section I, discusses the theoretical framework, while section II describes the political economy of the oil rent model and the budget making in Venezuela. The characterization of the budget outcomes are dealt in section III, and sections IV and V analyses the features of political institutions, actors and the policy-making process. Section VI provides an empirical assessment of the budget amendments in the approval and implementation stages and discusses the coefficients of interaction between the executive and legislative. Section VII offers econometric evidence about the main determinants of fiscal performance in Venezuela with special emphasis on the relative strength of the Executive and the Congress. Finally, some concluding remarks are presented.

I. Theoretical framework

In addressing the questions presented in this study, the project crosses the boundary between political science and economics. As in political science, this research studies collective choice and political actors and institutions. It aims to understand how budget decisions are made, and what shapes the incentives and constraints of the different actors taking those decisions (Persson & Tabellini, 2000). But, as in economics, this study is ultimately interested in the outcomes of budgetary decisions. From an economic standpoint, the Venezuelan budget alone determines the allocation of more than a quarter of the total economy's resources, and the combination of debt incurred and taxes collected to finance the budget has consequences on interest rates, exchange rates, human capital investments and many other areas. On the other hand, it is clear that economic efficiency and equity in budgeting can be superseded by what is politically feasible, given that the budget is the result of negotiations between different actors, from different groups, parties and ideologies which are often diametrically opposed. These factors argue for an investigation of government spending that is broader in scope than what is possible in either pure political science or economics. This study uses techniques from both disciplines to investigate important aspects of public budgeting.

In particular, the political institutions approach and the framework in both Scartascini and Olivera (2003) and Spiller, Stein, and Tommasi (2003) comprises the theoretical and methodological framework used in this study. Political institutions affect budget policy outcomes through their impact on the policy-making process by which budget policy is designed, approved and implemented. And budget policy is the outcome of complex exchanges among political actors that participate in the policy-making process. The features of the budget policies resulting from this process depend on the interaction and incentives of the actors involved in policy making and, thus, the actors' ability to achieve cooperative outcomes. Whether the working of the policy-making process facilitates or hinders cooperation will depend on some key features of this process. These features, in turn, will depend on the political institutions in place, such as the political regime, the electoral rules, as well as the rules governing the interactions between the Executive and the legislature, among other things (Scartascini & Olivera, 2003; Spiller et al., 2003).

II. The political economy of the oil-rent model and budgeting in Venezuela

Specialised literature often describes most of the governments of oil countries as 'rentier states' since they derive a large fraction of their revenues from external rents. Venezuela is an example of this model of development par excellence. The state has been the owner and administrator of oil rent and in the last three decades accounted for more than 80% of total exports, 90% of total foreign assets income and 50% of total fiscal income. At the same time, oil has a clear political dimension. A large concentrated rent source in national income can mould a country's social and political institutions. Therefore, it is the contention of this section that it is not possible to understand Venezuela's budget policy without accounting for the deep impact that oil has had in the main areas of its economy, political institutions and society. Consequently, this section briefly analyse the political economy of the budget-making policy within this oil-exporting nation. It argue that oil has been the single most important factor shaping budgetary policy in the country. This section lead to a greater understanding of the political economy dynamics discussed in the rest of the study.

According to Terry Karl (1999), actors in oil states do not behave in the same way they do elsewhere because they simply do not have to. When oil is the key source of wealth for a state, this revenue alters the framework of decision-making. Oil creates a perverse incentive structure shaping the behaviour of actors in the budget-making process. Oil shapes preferences, perceptions, and attitudes and explains, in high proportion, why fiscal deficits, high public debts and other disappointing budget outcomes are

likely even during a boom. The exploitation of Venezuela's oil has laid the basis for a rentier state and, in general, a rent-seeking society. This has been constructed on a principle of distributing rents where the state has maintained the citizens and not the citizens the state.

In particular, both private sector and government have rested on the dual capacity to extract rents and distribute them internally using political criteria as a central mechanism of allocation. Politically powerful interest groups attached directly to public spending, such as political elites, bureaucrats, public and private sector unions (e.g. CTV and FEDECAMARAS) have systematically tended to capture the state. Therefore, oil revenues have fundamentally shaped Venezuelan politics for decades, creating a rentier state legitimised by patronage and entrenched constituencies whose continued loyalty has been attached directly to state expenditures funded by oil rents. Consequently, governments have charged the lowest tax rates in Latin America and supported some of the continent's highest profits, wages, price controls and subsidies.

There are two specific direct mechanisms through which oil rents can shape budget policy. The first is fiscal income: taxation. When governments derive sufficient revenues from the export of oil, they are likely to tax their populations less heavily or not at all (Ross, 2001: 332). A second mechanism by which oil rents can shape budget policy is through spending: oil wealth may lead to greater and more inefficient spending. Oil income has provided Venezuelan governments with budgets that have been exceptionally large and unconstrained despite the country's low internal fiscal income. In turn, and as a consequence of these two mechanisms, citizens lack the incentives to demand budgetary transparency and accountability from their government.

In the rentier scenario which prevailed in Venezuela, especially after the first oil boom of 1974, politicians were more electable if they promised to provide more public goods and services without asking for the raising of taxes to cover their costs. Between 1970 and 1981, public expenditure increased by almost 11 percentage points from 16.3% to 27.4% of GDP; this was done almost without increasing the tax ratio in the same period. This was possible because of the huge oil fiscal income and the large share of the expenditure that was financed by government borrowing. The citizens did not perceive the costs of increased spending in many areas or programmes because 'oil paid the bill'. Since the state never had to compel their populations to accept taxes as regular and necessary levies on private interests to be used for public purposes, governments never created a clear separation between public and private resources, and the relation between spending and taxes was very weak. Therefore, in place of augmenting domestic productivity and internal tax income, governments sustained oil-subsidised activities whilst avoiding taxation. Thus, oil booms institutionalised a budget structure that almost inevitably led to rent-seeking behaviour on the part of the state, citizens and society in general.

In the Latin American context, Venezuela is a significant case for many reasons. Venezuelan experience tests the contention that the export of oil contributes to a fiscal pattern that differs substantially from other neighbouring countries. In particular, what is distinctive about Venezuela is not only the manner in which the country sought additional budgetary funds during the massive oil booms of 1974, 1979, 1984, 1990, 1996 and 2003-2004, but also how it used borrowing as a way of underwriting an extraordinary level of state expansionism, economic mismanagement, subsidisation and rent-seeking behaviour of public and private actors. What is also different is the support granted to Venezuela by the international finance community to continue its untenable fiscal patterns far beyond any economic rationality because it was a huge oil exporter. Rather than begin a gradual adjustment to a new reality, for many years Venezuelan governments were able to continue to rely on external debt to finance high levels of public spending.

The deeply ingrained belief that Venezuela was rich, as a result of many years of growing revenues and massive oil booms, undermined any efforts to demonstrate the contrary. Fiscal dependence on oil

developed the notion of the wealthy state without budget limits. At the same time, oil revenues, and the extraordinary high level of public expenditure that they facilitated, hid the institutional weakness and inefficiencies of the public administration for a considerable period. Furthermore, during the period governed by Pacto de Punto Fijo4, traditional parties5 used budgetary resources extracted from the oil industry as a key element for modifying pay-offs and sustaining political cooperation for many years. Various authors have discussed this relation between political institutions, oil and its effects on the party systems. Terry Karl (1986) has argued that oil was the economic factor that allowed the country to create the modern social conditions required for the formation of a cohesive party system. This explains the continuing support for the institutional pact that solidified the democratic transition after 1958. According to this argument, without oil there would have been little chance for democracy in Venezuela at the time (Monaldi et al., 2004: 10).

After the oil shocks of the 1970s and the huge income of 'petro-dollars', it was a fairly simple process to distribute oil revenues through the budget among different 'rent-seekers' in Venezuelan society. However, as oil rent faded and society became increasingly complex, the distribution process started to collapse either for lack of resources, for failure to reach important parts of the population or for the evident incapacity of the political parties to deliver. In particular, the decline of oil prices during the 1980s and the consequent drop in oil fiscal income were the origin of the rentier-state fiscal crisis. This decline in the oil fiscal income, sustained for more than two decades, in fact represented the demise of the oil-rent model of distribution that had been the basis of political stability for many years. Riots, attempted coups, electoral abstention, decay of the traditional political parties, and in general, the collapse of the political system have all been the most obvious manifestations of the decay of the model. Therefore, it should be no surprise that the decline of the old political and social model based on the 'rent' distributions through the state coincided with a general decline in oil fiscal income during the 1980s and 1990s.

III. Characterisation of the budget outcomes

This section presents different measures related to fiscal performance in terms of sustainability, efficiency, adaptability and representativeness of public expenditures. It shows that several measures point to problems of sustainabity of public finances, there are important issues regarding expenditure efficiency in several areas of public action, fiscal policy lacks flexibility, and using several indicators, the budget process has little representativeness.

Sustainability

Besides showing high volatility due to heavy dependency on oil revenues, fiscal policy in Venezuela has shown signs of being unsustainable. Several studies carried out during the mid 90s and the first part of the 21st century, using a wide variety of fiscal sustainability indicators, illustrated that the country's debt cannot be repaid in the future without radical changes in economic and fiscal policy.

[4] The process of elite bargaining of the post-1958 democratic transition led to the so-called *Punto Fijo* pact. This outlined a system which excluded 'extremist' parties from participating in government and allowed the development of a set of institutional designs to enable outstanding problems to be resolved by behind-the-scenes negotiation (Philip, 1999: 362).

[5]Venezuela has had one of the most extreme "partyarchies" in the democratic world, manifesting a high degree of party dominance in every relevant sphere: nominations, voting procedures, legislative behaviour, penetration of civil society, and influence over the media. During a long period of time this "partyarchy" was organised around two major disciplined and centralised parties: AD and COPEI.

Since the 1970s, public debt grew considerably and fiscal deficits have become chronic. For example, during the period 1990-2002, the overall fiscal balance of the Non-Financial Consolidated Public Sector registered 5 surpluses and 8 deficits, which range from -13.2% of GDP to 7.2% of GDP. In addition, total public debt went from 23% of GDP in 1998 to 35% of GDP in 2002, mainly because of an important increase in domestic debt. Table 1 shows fiscal deficit and public debt for the studied periods.

Table 1
Debt and Deficit Indicators

	70s	80s	90s	00-04
Fiscal Balance* (% of GDP)	-0.3	-3.8	-3.2	-3.7
Public Debt, total (% of GDP)	18.9	48.8	44.1	33.9
Public Debt, internal (% of GDP)	5.5	6.5	6.2	12.1
Public Debt, external (% of GDP)	13.4	42.3	37.9	21.8

* Excludes capital revenues
Source: Finance Minister

Calculating a simple debt sustainability indicator, the Blanchard index[6], Rios (2003) found that low GDP growth and the high cost of public debt were the main causes for the lack of debt sustainability in the Venezuelan case. According to his calculations and assumptions, to attain sustainability, the government needs to increase the projected fiscal primary balance in 1.4% of GDP. This result is susceptible to variations in GDP growth and interest rates. He concluded that policies conducive to higher growth and changes in the debt profile could contribute to improving the sustainability of public debt.

These results are confirmed by analysis carried out by the Garcia et al. (1997) the World Bank (2002) and the International Monetary Fund (2004). To further confirm these conclusions and using the data collected for the quantitative and econometric analysis done in this study, the methodology suggested by Hakkio and Rush[7] (1991) was replied. This exercise was carried out for Venezuela for the period 1968-2003 and it was found that during the period under study, Venezuelan fiscal policy was on an unsustainable path.

In brief, all the reviewed studies and all the calculations made for this study (using different measures and under different assumptions) show that the Venezuelan fiscal accounts are not sustainable in an inertial scenario and that the government constantly needs to apply fiscal adjustments in order to meet its obligations. To achieve sustainability over the medium and long-run, it is necessary a profound revision of the structure of revenues, expenditure and debt, and most importantly, to find mechanisms to isolate fiscal policy from the volatility caused by abrupt swings in oil revenues.

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[6] The Blanchard index measures the consistency of a given mix of fiscal policy by its capability of stabilizing the Debt/GDP ratio. In its calculation are taken into account the actual fiscal stance, the path of the fiscal primary balance, interest payments and the effects of exogenous factors on the debt stock.

[7] According to them, under a set of assumptions, an econometric measure of fiscal policy sustainability can be obtained by finding a stationary path for the first differences of total fiscal income, primary public expenditure and interest payments. An implication of this result is that if total fiscal income and expenditures are variables integrated of order one and both variables maintain a long run relationship, there exist a co-integration vector for them, and therefore fiscal sustainability holds that there is not a co-integration vector between fiscal incomes and public expenditures.

Efficiency

Efficiency of fiscal policy is measured as the capacity of achieving the goals established by the government in its different plans through the set of tools available (revenues, expenditures, debt, etc.). To assess the performance of the public sector it is also important to analyze how far are the authorities´ actions from the best way to deliver public goods and services in terms of costs and output. Given the array of public goods and services, the analysis of efficiency is carry out using specific examples in the areas of capital and social expenditures. More specifically, the cases of infrastructure and education will be presented.

Venezuela has been known for having one of the best infrastructure networks as compared with the rest of Latin America. For example, the country fares well in the region regarding indicators such as the extension of highways and roads (95.155 Km. of which 32.300 Km. are paved ways) and the number of ports and airports per capita (CONAPRI, 2002). However, investment in infrastructure has declined considerably in recent years and lack of maintenance has deteriorated many of the public goods and services in this area. According to CONAPRI (2002), investment in infrastructure went from a maximum of around 3.5% of GDP in 1977 to close to 0.5% of GDP in 2000. The main reasons for this have been the worsening in the economic situation since the eighties and the perverse incentives by policy makers and legislators to cut capital expenditures rather than current expenditures in crisis and fiscal adjustment times.

The breakdown between the different economic components of the budget, and particularly between current and capital expenditures, allows us to analyze the long-term effects of budget decisions in terms of efficiency. A relevant question is: did Venezuelan governments, during the fiscal contraction of the last two decades, make the necessary but painful cuts in current spending whilst protecting capital spending to promote economic growth and efficiency or did they follow political expediency and do the opposite?

A key trend in the economic classification of budget was a sharp cut in capital expenditures and increases in the current expenditures (as percentages of both GDP and total expenditure). In particular, the huge increase in current expenditure is a significant indicator of the distorted pattern followed by public expenditure in recent years. This increased substantially as a percentage of the GDP during the 1970s, going from 12.3% in 1974 to 14.3% in 1980; by 1999 it was 50% higher than in 1974 (17.1% of GDP). In contrast, capital spending declined from 7.3% in 1974 to 3.4% of GDP in 1999. In many years the current expenditures alone surpassed the annual value on oil fiscal income, a pattern that became a permanent feature in the second part of the 1980s and throughout the 90s. Table 2 shows expenditures classification for selected years.

Table 2
Classification of Public Expenditures
(% of GDP)

	1974	1984	1994	2004
Current expenditures	12.32	16.94	16.61	20.40
Consumption expenditures	6.13	5.63	5.13	5.86
Wages and salaries	5.15	4.9	4.29	4.67
Purchases of goods and services	0.98	0.73	0.84	1.19
Current transfers	5.79	5.63	6.93	10.75
Capital expenditures	7.35	3.32	3.39	5.94
Direct investment	2.86	1.1	0.59	0.45
Capital Transfers	4.49	2.22	2.8	5.49
Financial applications	15.49	4.39	2.234	2.80
Total	35.16	24.65	22.234	29.14

Source: Puente, 2005

Moreover, capital items are in competition with current expenditures, which are regular and recurring. Capital expenditures can be delayed, their exact timing is usually not important in the short term; current expenditures, by their nature, have to be paid out regularly. Deferring capital-intensive projects, such as new public hospitals or motorways, is much easier than laying off public workers or delaying debt payments. This response is consistent with the view that political decision-makers generally focus on the short run and heavily discount the future. Moreover, considerations of political economy suggest that cutting current spending, such as wages and consumption spending is often difficult because such spending benefits politically influential interest groups (e.g. public sector employees and the army). In the same way, any scope to increase spending following adjustment tends to benefit these same groups. In consequence, the relative stagnation or reduction in capital spending and investments in Venezuela seems to reflect policy substitution toward politically more important transfer payments and other current spending items. As a result of this phenomenon that have resulted in insufficient investment in public capital goods, today the Venezuelan economy is less efficient and has increasing difficulties to growth and develop.

Another example that illustrates the inefficiency in the use of public resources is found in the education sector. Within the total social expenditures, education has received the larger share, reaching an average of around 5% of GDP since 2000 from a mean of about 4% of GDP in the 90s. Despite high expenditures in education, a study by the World Bank (1999) shows that key indicators such as primary enrolment, dropout rates, and coverage of secondary and primary education are below Latin American standards. In addition, most of the expenditure is allocated to pay wages, salaries and administrative outlays while there are important gaps in the provision of other inputs such as teacher training, books and other materials that are an integral part of good education system. Moreover, the quality of education remains low, and there are several disparities in the allocation of the resources within the sector. For example, there is a bias towards the funding of tertiary education in detriment of primary and secondary education.

These cases exemplified that there are serious problems of efficiency and equity in the allocation and execution of the Venezuelan budget. Many of the issues described here can be generalized to other areas of the public sector action and translate to the budget design and implementation. Clearly, the provision of public goods and services is far from attaining the goals set forth by the government and contributes little to the improving in the living conditions of Venezuelans.

Adaptability

To determine how adaptable is the Venezuelan budget, two aspects are taken into account. Firstly, the response of fiscal policy to economic cycles could shed light on the capacity of government to mitigate GDP contractions or expansions. In general, it is desirable that the government keeps a counter-cyclical fiscal policy stance to ease unexpected economic shocks. Secondly, the main legal and political budget rigidities are accounted for to determine what portion of the budget can be used freely by the executive.

If a fiscal policy is counter-cyclical, then the government can save in periods of economic boom and use the saved funds in times of recessions. For the case of Venezuela, Rios (2003) isolated the fiscal accounts from economic cycles and changes in oil prices to obtain a structural fiscal balance. He found that even when the main sources of shocks are suppressed from the fiscal accounts they remain very volatile, which could be an indication of a pro-cyclical fiscal policy. To explore the issue further, Rios estimated the fiscal impulse[8] and compared it with the gap between current GDP and potential GDP[9]. He found that when current GDP is above potential GDP, in general, the fiscal impulse is positive and when current GDP is below potential GDP, most of the times the fiscal impulse is negative. This confirms that fiscal policy in Venezuela is almost always pro-cyclical. Other studies, such as Garcia et.al. (1997) and World Bank (2002), obtained similar results.

The second aspect to take into consideration is the share of the budget that can be assigned freely once legal requirements and current expenditures that are very difficult to cut (for political or financial reasons) such as public employee's wages and interest payments are subtracted from the budget. For example, in 2003 the budget legal and contractual pre-allocations amounted to 52% of the budget, and if wages and salaries for civil servants and allocations for interest payments are added, then the margin for fiscal management is even more limited[10].

In conclusion, the evidence presented here shows that the Venezuelan budget lacks adaptability when confronted with unexpected changes in economic conditions. This is because most of the time the fiscal policy is pro-cyclical and the government exacerbates shocks to economic activity. Moreover, budget legal requirements and difficult-to-reduce current expenditures amount for a considerable share of total budget, which impairs the government to adjust fiscal policy when facing a changing economic environment.

Representativeness

There are several definitions of representativeness of the fiscal policy that can be found in the literature. One definition refers to the extent to which the allocation of resources reflects the preference of the population at large or of organized interest groups. Another definition relates to the planning process by which public resources are allocated. Finally, it can be associated to the regional allocation of resources depending upon factors such as population, income and poverty rates.

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8 The fiscal impulse is derived from the autonomous components of public finances (those independent of the economic cycle, commodities prices and interest rates) and is defined as a temporal change in the structural primary balance.

9 Potential GDP was calculated estimating a Cobb-Douglas production function with constant returns to scale. It measures how much the economy can growth given initial endowments of production factors and neglect economic fluctuations.

10 See box 1 for additional analysis about budget rigidities in Venezuela.

With respect to the first definition, in Venezuela the preferences of the population are canalized through the electoral system, although particular interest groups influence resources allocation by lobbying at the executive and legislative level. Some regional governments have implemented participative budget, and citizens can have a saying in budget matters, especially those that affect their communities. However, this practice has been rather limited. In addition, every new government is obligated to present at the beginning of its period a national plan, which contains the priorities and policies that were promised during the electoral campaign. However, many times this is an exercise of a conceptual nature with little participation by civil society or organized groups. Additionally, there is not formal evaluation of the implementation of the plan.

In some instances, powerful interest groups can influence the allocation of resources for their benefit. Such is the case of universities. One important feature of education expenditure is its concentration on higher education. Pre-school and elementary education, which in 1999 accounted for 80.9% of all students enrolled in the education systems, received only 11.5% of the total budget for education. For its part, higher education accounted for only 12.6% of enrolled students during the same period and received as much as 40% of the budget. The high and growing concentration of education expenditures over the last two decades has resulted in educational expenditure having a highly regressive component. This situation is very difficult to change because universities are a powerful and organized interest group.

IV. Characteristics of political institutions, actors and policymaking process

Venezuela's economic dependency on oil has impacted the institutional setting, policy making processes and public policy outcomes, especially the budgetary process and its outcomes as the budget is one of the main mechanisms through which the oil revenue is distributed. Notwithstanding, changes in the economic and oil revenue conditions are not the only explanation for modifications in the different stages of the budget process throughout 1974 and 2004. Also, changes in the rules of the game and in the functioning of the political institutions have played a significant role in such variations.

Based on the methodological framework in Scartascini and Olivera (2003) and Spiller, Stein, and Tommasi (2003), an analysis of the institutional determinants of the political game that affect the incentives and constraints of the main political actors with influence over the budget-making process will be developed throughout the rest of this study. Monaldi et al (2005) is used as main reference for the description of the general institutional arrangements and policymaking process in Venezuela.

The rules of the political game that influenced the institutional framework in Venezuela varied within the 1974-2004 period. Also, political incentives and constraints that affected the political actors, influenced the policymaking process and the subsequent policy outcomes present varying trends, and in the last two decades public policies in Venezuela can be generally characterized as having very low quality.

To set an analytical framework that adjusts to the distinctiveness of the Venezuelan case, for the purpose of this study the period 1974-2004 is separated into three sub-periods (1974-1988, 1989-1998, 1999-2004), broadly characterised as:

> First Period (1974-1988) - Strong Presidential power within a cooperative system strongly influenced by a corporative arrangement in a limited political competitive context.

Second Period (1989-1998) - Weakened Presidential power and stronger Congress within a non-cooperative system and a fragmented political context.

Third Period (1999-2004) - Constitutional and informally powerful President with no political competition.

These periods are described and analyzed separately, as well as jointly, in order to develop a better knowledge of the dynamics involved in the budget making process.

First Period (1974-1988)

The institutional framework during the first period (1974-1988) was embedded within the Pact of *Punto Fijo* and the 1961 Constitution. (Monaldi et al, 2004). A constitutionally weak but informally powerful president guaranteed the main party leaders veto over major policy changes. High degrees of inter-party cooperation, incentives for centralized disciplined parties in the electoral system, presidential elections held concurrently with all legislative elections, lack of regional elected officials, and lack of expertise of legislators in the decision making process are also other of the fundamental institutional foundations of this period.

This period comprises the last fifteen years of democratic consolidation in Venezuela, and under the theoretical perspective of Spiller, Stein and Tommasi (2003), it can be typified as having an environment conducive to political cooperation given the participation of few political actors, stable actors (repeated play) and low stakes of power. Stability was privileged over flexibility or efficiency and a two-party cartel-like political arrangement that had evolved since 1958 between the two major parties (AD and Copei), became a scheme that by the end of the period 1974-1988 was exacerbated. Minority parties such as MAS were guaranteed access to small prerogatives to maintain them "inside" the system, but they did not have major policymaking role. Corporatist´s arrangements were also formally incorporated and used as vehicles to channel through interest group concerns. Thus, concurrent agreement included the umbrella organization of the labor unions (*Confederación de Trabajadores de Venezuela* – CTV) and business groups (*Fedecamaras*), as well as the Catholic Church and the military. From the key players, the only group explicitly excluded was the communist party (PCV). The two main parties (AD and Copei) generally controlled the leadership of Congress, and with some few exceptions they also heavily influenced the leading corporatist groups. Party leaders were quite powerful with strong roles: they enjoyed relatively long tenures, almost all of them were members of Congress following long legislative careers, had significant control over congressional nominations and decided how the party voted in Congress. Such corporatist arrangements permitted the president to conduct policy consultation with a reduced number of actors. The marginal role of legislature in the policymaking process was evidenced by the predominance of policy agreements negotiated between the president, the national party leaders and the peak corporatist groups, that given the disciplined party delegation in the legislature, these agreements, if required, were stamped into law. It was common for Congress to delegate legislative authority to the president.

The favourable oil scenario during part of this period made the distribution of the oil revenues a key political element, influencing also the budget making process. The oil booms shaped political distortions as the abundance made the executive branch more powerful and the increased stake of power triggered deviations from a cooperative behaviour, amplifying incentives for inefficient behaviour and corruption.

The stability, coherence and some building of policy capacities observed before 1974 started to decline during 1974-1988. Certain policy processes were unravelled and inefficiency in several areas became

too evident. Notwithstanding, a number of key areas, such as the oil industry and the central bank, still preserved relative good quality policymaking capacities.

From the budget-making process perspective, the President had broad and significant powers, which combined with a bipartisan political agreement within a corporativist arrangement, resulted in a limited number of actors interacting throughout the different stages of the budget process. Presidential power was strongly exercised in the allocation of budgetary resources in order to keep political cooperation (congressmen reelections and resources geared towards powerful interest groups), but eventually it became an unsustainable scheme.

Finally, it is important to mention that Presidents who wanted to restrain spending and maintain budget discipline in the 1970s and during an important part of the 1980s could achieve this goal to the extent that they could depend on extensive and disciplined support in Congress. However, these same conditions, paradoxically, helped other Presidents accelerate spending. Therefore, the stability of institutions and the political system did not necessarily imply budgetary discipline and the Venezuelan experience has been a good example of this, in particular during the 1970s and the 1980s.

Table 3. Policymaking and the Budget-making process

1974-1988	1989-1998	1999-2004

• **Institutionally cooperative PMP and BMP**
• **Low number of key players** - allowed budget consultation with very limited actors.
  ◦ President
  ◦ Leaders from the two main political parties (AD and Copei)
  ◦ Leaders from peak unions (CTV and Fedecamaras)
• **Stable Actors** (repeated play)
• **Low stakes of power**
• **Powerful President** - Constitutionally weak but informally powerful, important power in BMP, and strong partisan powers, control over high oil rents, rights to appoint cabinet members and regional governors.
• **Political Arrangement** – Two-party cartel-type.
• **Party system** - highly centralized, disciplined and non-fragmented.
• **Party Leaders** – long tenures, with control over congressional nominations, and many were members of Congress.
• **High inter-party cooperation**
• **Marginalized legislature** – mainly controlled by the two main political parties.
	• **Decline and breakdown of cooperation** – political fragmentation.
	• **Volatile BMP**
	• **Higher number of fragmented and polarized actors** – new actors: newly elected regional authorities and new political parties with significant participation in Congress.
	• **Higher transaction costs**
	• **Low stakes of power**
	• **Weaker President** – loss of control over budget and governors, reduced influence in Congress, need for political coalition. Oil income decline.
	• **Party system** – decline in discipline, fragmentation.
	• **Institutional instability**
	• **Stronger legislature power** - despite fragmentation and polarization.
		• **Weakening of cooperation** – political fragmentation, instability, partisan policymaking and increased confrontation.
		• **Higher transaction costs**
		• **Increased stakes of power**
		• **Strong President** – constitutionally and informally powerful with strong concentration of powers and important role in the budget process.
		• **Many changes in formal and informal powers**
		• **Weakening of institutions and accountability**
		• **Governance quality declined** – increased cabinet turnover
		• **Weakening of the legislature** – given stronger role of the President and strong discipline within the government party members.

Source: Own analysis that heavily relies on Monaldi et al., 2005

Second Period (1989-1998)

This second period, in contrast with the preceding, was characterized by multiple actors (subnationals actors among many others), high electoral volatility and institutional instability. During this period democracy in Venezuela started to deconsolidate and cooperative agreements to decline. The previously prevailing political arrangement fractured and leaded to a greater political fragmentation, weaker presidential power and stronger Congress influence in policymaking, particularly in the budget process. Transaction costs increased and budget outcomes significantly deteriorated.

Presidential power weakened and the introduction of regional elections in 1989 activated the formal federal system that had been historically dormant. The rise of federalism transformed party politics as it increased the number of electoral arenas and competition. The non-concurrency between regional and presidential elections and the possibility to re-elect governors and mayors gave new regional political actors the opportunity to gain independence vis-à-vis the national authorities. Despite the modifications in the legislature system in 1993, from a pure proportional representation to a mixed-member system of personalized proportional representation, the system continued to be globally proportional. In 1993, incentives for political fragmentation grew and the decline in party discipline was every time more evident. Thus, institutional and political instability became the norm.

The presence of many fragmented and polarized actors changed the political scenario, and a volatile process evidenced the weakening of cooperation. With varying degrees of formal and informal powers, new key actors, such as the military, civil society groups, and regional authorities appeared in the political scenario.

The substantial increase in transaction cost, reflected by the multiplication of relevant policy actors at the national and regional level, made it more difficult for political players to credibly commit and to reach policy agreement in more informal environments. Paradoxically, despite the increase in political players, the legislature played a more significant role during this period. Closer electoral connection of legislators to their constituents made legislators more specialized and less disciplined to the party leaders and parties that nominated them. Independent legislative groups emerged that were the result from the separation of some factions from consolidated political parties. Dependency of national political parties on party alliances increased during this period, and incumbent governors could shift partners more easily to assure re-election, increasing their independence from their original parties.

The decline in presidential powers was strongly influenced by the introduction of regional elections, and it was evidenced by his loss of control over part of the budget (given the constitutional allotment to the regions), and over the discretionary appointment and dismissal of governors. Also, the political currency of presidents was reduced by the combination of declining oil fiscal income and market-oriented reforms, which limited subsidies and reduced rent-seeking opportunities (Villasmil et al., 2004). A weaker president figure reduced the executive branch influence in the legislative process, very evident in the budget-making process. In 1998, with the purpose of reducing the effect that the potential landslide-victory by Chavez might have on the legislature, Congress approved the separation (for the first time) of the legislative and presidential elections due on that year. Notwithstanding, it generated the largest political fragmentation in the history of Venezuela.

Third Period (1999-2004)

Hugo Chavez's revolution and the 1999 new Constitution characterized the third period (1999-2004), with a significant effect over the institutional and political landscape: presence of a constitutionally powerful president, greater concentration of power, increased stakes of power, weakening of accountability, political instability, polarization, acceleration of political confrontation, partisan policymaking and weakened political cooperation. Despite greater polarization, power was

consolidated within one political party. Many formal and informal powers changed during this period, and a decline of civilian control or relevance over the military became one of the most salient features after the election of Hugo Chávez.

Congress power in the budget process declined, and while the Presidential powers were strengthened and the Executive branch retook its stronger role over the budget process, compared to the first period, this time the President exercised his power within a non competitive political context.

Governance and institutional quality declined, reflected in many cases by the reversal of several reforms implemented during previous administrations, increase in cabinet turnover, and deteriorated perception about many public institutions. An example has been the credibility loss experienced by the Supreme Court, which contrasts with cases of judicial independence displayed in previous years, such as President Pérez's impeachment in 1992. Similar loss of credibility was experienced by the Central Bank and by the National Electoral Council (CNE).

During the second and third periods (1989-1998 and 1999-2004), the progressive deterioration in the quality of public policy features became evident given the increase in volatility, incoherence and disinvestment in policy capacities. The success of reforms in specific areas, such as oil opening and privatization, and the presence of capable technocratic teams were shortly lived during these periods, given political instability and lack of State capacity.

V. The budget-making process: actors and stages

The main purpose of this study is to understand the budget process in Venezuela emphasizing the role of actors with substantial influence over the budget. However, since budget policy may depend on the intricacies of the decision-making, it is important to comprehend the whole process of budget formation and, in particular, be aware of the structure and operation. The aim of this section is to describe the actors involved in the budget-making process, their relation to one another, the formal and informal powers they possess and how they tend to exercise them throughout the different stages.

Actors in the budget making process

Interdependent choices of a plurality of actors with specific capabilities, perceptions, and preferences regarding outcomes, are part of any budget-making process, and Venezuela is no exception. It is likely that no actor is able to determine the outcome unilaterally, though some might have stronger influence or power. Therefore, what plays a crucial role in the end is the "actor constellation" [11], defined as the set of actors that are actually involved in a particular policy interaction – budget process in this case- and the level of potential conflict or collaboration that could be present at any given time. The multiplicity of actors involved have diverse levels of powers and incentives that can shift over time according to changes in political influence as well as to institutional setting and certain rules of engagement.

In the case of Venezuela, there are three main global actors and that will be described and analyzed in this section: the Executive, the Legislative, and the set of diverse informal actors - such as interest groups that include political parties, among others. Notwithstanding, after the decentralization process after 1989, sub-national governments became an influential actor, but not necessarily as important as the other three actors mentioned.

[11] Scharpf, Fritz W (1997)

Within each group, there are subsets of players with varying degrees of formal roles and informal powers. Cases like the Judicial branch, which has a formal role in the Evaluation and Control Phase of the budget process, displays limited power in real terms and will not be included in this section.

Executive

In the broad sense, the influence of the Executive branch includes the power of the President and of different institutions of the Executive: Ministry of Planning and Development (CORDIPLAN), the Ministry of Finance, the tax office SENIAT, the OCEPRE, budget units of the public sectors offices, Central Office of Personnel, and the Central Office of Statistics, among others. Nonetheless, in the elaboration of the budget proposal by the Executive, important interactions take place with other public sector institutions, such as the Venezuelan Central Bank, and with public sector companies, like the oil company –PDVSA- which plays a very influential role in the estimation of oil revenues and oil prices in the budget proposal stage.

<u>The President and his Cabinet</u>

Until 1999, Presidents in Venezuela were elected for a period of 5 years with no immediate reelection possibilities, and could run again for office after 10 years from previous presidential term. Two cases of presidential second timers in such scheme were experienced in Venezuela, with interesting implications as to their power vis-à-vis the Legislative, given the trend of political fragmentation that the country started to experience by the end of the 1980s. The first case was in 1989 with the election of Carlos Andrés Pérez, who run under his traditional political party AD and was elected with 53% of the popular vote[12]. Perez survived a coup, but given political fragmentation in the country at the time, and even with the control of 48% of the Congress seats by the government party he confronted difficulty in passing many topics of his policy agenda – among them budget issues- and was impeached in 1992.

The second case of an ex-president re-election was in 1994, when Rafael Caldera won with a coalition group that included his new formed political party, Convergencia, which individually achieved only 17% of the popular vote and 13% of the seats in Congress[13]. His weak legislative situation in terms of party support created conditions for greater number of concessions and bargaining processes. The increase in active political parties in Congress, particularly during the period 1994-1999, increased the negotiating process between Congress and the Executive during the budget-making negotiations, and evidenced the weaker stance of the Executive.

In the budget process, the Executive has the formal power to submit a budget proposal to Congress, which -after possibly amendments to the proposed budget- approves it. Thus, the power of the government party in Congress becomes an important variable. In general, procedures are crucial, but in particular voting procedures, because they establish who has influence on the final budget document, as well as when and how. Therefore, the proportion of seats controlled by the government party -or coalition group- was essential during the phase of increased number of effective parties in Congress (1989-2000). Until 1989, the President – though constitutionally weak- had strong power in policy matters, but the evident shift in the distribution of power in the Legislative curtailed and limited the President´s influence over many policy issues, particularly over the budget-making process. Nonetheless, the Executive branch has the formal power to put a default budget into force in case Congress does not approve the proposal.

[12] See annex 2
[13] See annex 2

As for the Cabinet, besides CORDIPLAN and the Ministry of Finance – who have an active formal and informal role in the whole budget process - other ministries also have a formal role, mostly by the fact they are required to submit the projects of their ministries that might need external funding. Some ministries have greater informal power than others to influence on the budget allocations. The informal influence of a certain minister over the Finance Minister or the OCEPRE´s analysts regarding the soundness of his budget needs and proposal is an important aspect of the budget-making process, as it could affects the final allocation or resources among ministries. Additionally, an important aspect is that a minister's possible lack of influence could significantly affect his credibility within his ministry and even among his colleagues, affecting his political stance.

Following the formal procedures, after deliberations at the Economic Cabinet, the President in the Council of Ministries has the responsibility to approve the final budget proposal and set any unresolved conflicts regarding expenditure allocations that could arise between individual agencies and the OCEPRE. Under these conditions, the power of the President in the formulation stage of the budget process is also paired by the influence of key ministers, who could display important influence due to their specific functional roles, self interested concerns with organizational and political survival, growth, reappointment or career advancement.

The constitutionally and informally stronger figure of the President after 1999, combined with an almost hegemonic Congress -represented by the Government political party- has implied an almost rubber stamped approval of the Legislative to the Executive budget proposal or changes.

Main Ministries: Finance and Planning

The Ministry of Finance is one of the principal actors in the coordination of the budget-making process. CORDIPLAN – the planning ministry- is mainly responsible for preparing the Country Development Plan (Plan de la Nación) during the first year of a given administration. The plan describes the general guidelines embedded in the budgetary policy. Given that the necessary macroeconomic variables forecasts and systematic strategic use of macro projections underlying the budget are the exclusive responsibility of the Executive, the heads of CORDIPLAN and the Ministry of Finance team up to estimate such projections. The Ministry of Finance – under which relies the tax authority SENIAT- sets the estimates of tax revenues. Until 1999, before the new public finance and budget regulations were enacted, it was the responsibility of CORDIPLAN and the Public Credit Office of the Ministry of Finance to elaborate the first version of the Law of Indebtness for Programmes and Projects (*Ley Paraguas*), that was used by OCEPRE to set the final budgetary spending level in the proposed budget. Since 1999, though CORDIPLAN and Ministry of Finance are still responsible for any debt estimation, the process now follows the scheme embedded in the LOAF.

Even though the Ministry of Finance is formally the central figure in coordinating the budget process, during 2002-2003 the Ministry of CORDIPLAN played a more central role in the process[14]. Though the objective was to use the budget as a medium term planning tool, the political context - based on a commanding presidential figure- altered certain dynamics between actors and has made the budget more of an accounting tool with a stronger political influence. Given the political agenda, budget composition tended to be significantly influenced by the President preferences on social programs and other spending requirements rather than on certain analytical criteria for spending efficiency, effectiveness and sustainability. As in previous periods, the success of certain ministers in obtaining extra funds relied on their influential power, but in this case not as much due to their proximity to the

[14] During those years, the Minister of CORDIPLAN was even the Head of the Economic Cabinet, a position formally and traditionally assigned to the Minister of Finance.

Minister of Finance or the Minister of CORDIPLAN, as it was the case in preceding years, but on their proximity to the next upper level in Government: the President.

<u>OCEPRE, Government Agencies and public entities</u>

Government agencies, mainly leaded by the agency head and his budget staff, play an important formal role in the budget-making process, as they provide OCEPRE with the preliminary branch budget estimates that are to be embedded in the overall government budget proposal. Budget analyst in the agencies play a role as communicators of policy priorities and have some discretional powers. Close contact between OCEPRE and the agencies aims to provide the budget office with a better understanding of the agencies budget needs despite the fact that agencies tend to inflate request and OCEPRE follows a practice of request reduction. Thus, OCEPRE head and its analysts with their estimates for development policies, level, composition, and orientation of the revenue and expenditure, as well as main priorities at sectorial, regional and institutional levels have a strong influence over the final budget proposal. None withstanding, OCEPRE has little effective control over oil and non-oil revenue projections, as this is closely guarded prerogative of PDVSA and SENIAT.

Among the many responsibilities as budget office OCEPRE: determines the global expenditure levels after using the macroeconomic forecasts provided by CORDIPLAN and the Ministry of Finance; holds budget-review sessions during the formulation stage; reviews and consolidates the individual entities budgets; sets final allocation decisions; reviews–in coordination with CORDIPLAN- the first draft of the Annual Operating Plan and the *Exposición de Motivos* of the budget submitted to Congress; and during the execution stage, it may defer or cancel part of the authority of operating offices if revenues fall short of expectations or delays are experienced in spending.

Legislative

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All the legislative action on the proposed budget starts at the Finance Committee, with the president and members of the Committee as powerful actors that may have great influence in the shaping of the final budget. Although other committees may have a saying in budget issues regarding their particular topics, usually they do not get involved directly in the budget discussion. In an interview, Francisco Rodríguez, Director of the OAEF during the Chavez administration, expressed that in fact the Finance Committee- in general- took budgetary decisions without consulting thematic committees; thus, one of the biggest political negotiations carried out among parties once a new Congress was elected was the choice of president and other members of the Finance Committee.

Congress has the power to change priorities and add or cut public works, but it cannot alter the overall spending levels. Also, legislators can object to revenue estimations and macroeconomic forecasts, and request to the Executive their review or adjustment. This pattern was more common during the second period studied, when Congress had a stronger stance. Supplementary budgets may be enacted by the Legislative, and given that these tend to be less carefully scrutinized during

legislative debates than the initial budget approved, they are a channel for excessive expenditure and budget indiscipline. The excessive use of these powers by Congress and its implications are analyzed in more detail in following sections.

During the first period under study (1974-1988), the Government party had majority in Congress and also leaded the presidency of the Finance Committee. Such control, paired with strong party discipline evidenced a period of weak Legislative power, and the unity of purpose between the Executive and Legislative minimized the "separation of powers" between chambers and the President. Prior to the decentralization process in 1989, the Senate had no significant veto power in policymaking, but even still after 1989 the power of the Senate was still very weak. In the budget making process the Senate would usually ratify – after any necessary debate – the Lower Chamber's approval of budget.

From 1989 until 1999 – the second period under study- the political fragmentation in Congress, the visible decay of tight party discipline, and an every time weaker link between the government political party with majority in Congress and over the Finance Committee, strengthen the role of the Legislative, particularly over the budget process and spending composition. After the 1999 Constitution, the change from a bicameral to a unicameral legislature introduced a new set of formal and informal dynamics, which in many cases have been exacerbated by the almost hegemonic control of the Government party in Congress and in the Finance Committee. Inter and intra political party collaborations varied with a weakening of cooperation among political parties, but greater intra-party cooperative behaviour, especially within the government party.

The intense lobbying activities of congressmen for increases in spending as well as in enlisting Executive officials to sponsor the necessary amendments evidence, in many instances, the great level of informal power of the Legislative. Congressmen, like spending ministers, could propose amendments that benefited their constituents or groups of interest, failing to internalize the budget costs associated with these measures. With the elimination of the Senate as the geographical representation in the legislature, many congressmen have informally assumed part of the previous Senators roles in strengthening links with certain governors and - given the stronger power of the Executive- in trying to influence over many spending ministers in order to promote increased allocations to certain regional and functional activities that they will eventually ratify during the legislative approval stage.

Interest groups

Many interest groups looking to protect their "rent" in the budget allocation have diverse degrees of power on the composition of the expenditure levels, significantly affecting the inertia and rigidities present in the budget allocations. Informal actors, such as government employees and others perceiving benefits from the budget, pressure politically for large increases or to avoid reductions of resource allocation, adding steam to any political tension or unresolved conflicts at the different stages of the budget process.

There are strong lobby groups in the legislative, and they mostly operate through three large groups: the unions, the political groups with general influence and with enough electoral weight – both in public elections as from the inside- and political authorities, especially in AD and COPEI during the first two periods analyzed, and later on in the MVR.

Political parties and politicians at large, with their tendency for short term results that could provide them with an enhanced political stance, tend to pressure in different stages for the allocation of resources to specific projects, sectors or geographic regions of their interest. The use of "additional

credit" – analyzed in following section - is many times due to pressures of diverse interest groups and their allies within government for application of extra funds to activities that might have been curtailed from certain areas during the budget proposal and approval stages.

An example of an interest group that has also been very influential in the budget process- particularly in the budget implementation- is the military sector. The pressure exerted by this group has been evident by the great weight of military projects in public credit, with such investments depending practically on supplementary budgets and, prior to 1999, also through the Indebtness Law (*Ley Paraguas*).

The Sub-national governments

In Venezuela - since the decentralization reform in 1989 - sub-national governments became a new actor in the overall legislative and budget process, though not as influential as the other mentioned key players. The shift from a scheme based on governors "appointed" and freely removed by the President (1958 to 1989), to a scheme of "elected" officials (since 1989) increased the significance of sub-national governments and reduced their stigma as agents of the Central government. Governor's elections had a profound and unintended effect on the Venezuelan party system, as it diminished power of national party leaders of the two traditional political parties - AD and COPEI. Part of their increased power - gained by elected governors over time- is that they have become leading contestants for presidential elections.

It has been argued that a constitutional federal structure could be a relevant factor in the role of sub-national governments, but as mentioned in Monaldi (2005), the relevant factor is not if the constitution defines the country as federal, but if the specific institutions (federal or not), and party structure, establish incentives and opportunities for the governors to exercise influence in the national policymaking process.

The influence of sub-national governments in Congress, particularly through the Senate, is enhanced in the case the districts for elections of Senators and governors are the same – as it is generally the case when there is a territorial chamber (Senate), and was the case of Venezuela until 1989- because the potential for electoral connection between the governors and senators tends to be higher, especially if elections are concurrent. Nonetheless, as expressed in Monaldi (2005), the 1999 Constitution changed the institutional framework that could promote such connections, as it changed the legislature from bicameral to unicameral and limited the possible concurrency of elections[15]. Venezuela became an exception from the typical characterization of federal countries, in which there are two chambers in the legislature in which one of them – generally called Senate- is based on territorial representation rather than population[16].

Once described and analyzed the main actors in the budget process, the description of their links with the stages in the following section will provide a more comprehensive outlook to understand the overall budget process and its outcomes.

[15] As Presidents have a six year term, congressmen a five year term and governors a four year term.
[16] Monaldi (2005)

Stages of the budget-making process

In the budgetary process designated organizations and individuals have defined responsibilities which must be carried out within a given timetable. In Venezuela, this process is established and controlled by the legal framework (the Constitution, the Organic Budget Law, special laws and legislative process rules). The budget process can be divided into four stages that involve several activities, negotiations and actors: an Executive planning stage, a Congressional approval stage, an Executive implementation stage and the evaluation and control stage (table 4). In order to understand the mechanism of the budget process and the scope for a change in budgetary procedures, it is important to take all four stages into account, and in particular the set of incentives and constraints the different actors[17] are subject to at each stage (Milesi-Ferreti, 1996: 8).

Table 4. Stages of the Venezuelan budget-making process

Actions
Formulation Stage
• Formulation of budget targets and guidelines • Preparation of budget bids • Compilation of budget draft • Reconciliation • Finalization of budget proposal
Approval Stage
• Debate, amendment of, and vote on budget proposal • Reconciliation between upper and lower houses • Approval by government
Implementation Stage
• Execution of the budget act • In-year changes of the budget
Evaluation and Control Stage

Source: Modified version based on Von Hagen and Harden, 1995 (Puente, 2005)

Formulation stage

This stage consists of the drafting of the budget law by the government. It begins several months before the relevant fiscal year starts and ends with the submission of a draft budget to Congress. It involves the setting of guidelines, bids for budget appropriations from various spending departments, ministries and offices, the resolution of conflicts between Executive spending interests, and the drafting of the revenue budget.

The formulation of the budget takes between three to five months to complete, and almost all the institutions of the Executive participate: OCEPRE, budget units of the public sectors offices, the Ministry of Planning and Development (CORDIPLAN), the Ministry of Finance, General Controller, Central Office of Personnel, Central Office of Statistics and the Venezuelan Central Bank. The process culminates with the budget's delivery to Congress. However, these institutions' involvement in the Executive budget-making process could be summarised and associated with one of four primary 'actors'. These performers, in order of their appearance, are the heads of government agencies, OCEPRE, the President and Congress.

The inception of the budget starts with the development of a Previous Budgetary Policy. It defines the orientations, priorities, norms and procedures to which all the institutions of the public sector should adjust. There are two practical and parallel ways in which to scrutinise the tasks of formulation of the Previous Budgetary Policy (AVPP, 1995: 206). One of them consists in the preparation of a preliminary budget made by each public institution for its presentation to the OCEPRE. The agency head and his budget staff, with all of the branch budget estimates in hand, attempt to co-ordinate these parts in order to form the first rough budget estimates for the entire agency. This method has the advantage of knowing in precise form the aspirations and necessities of the different offices. However, that same advantage becomes a disadvantage, because the aspirations of the institutions normally exceed the financial possibilities, which later force governments to make substantial reductions. These reductions by virtue of not being framed inside a global orientation of the budgetary policy lack coherence.

The second and parallel form of defining the Previous Budgetary Policy consists in OCEPRE giving bureau chiefs a rough target estimate of what they can expect in their total budget. On the basis of these target figures, agency administrators develop expenditures estimates of sub-programme categories to remain within overall budget constraints. These budget estimates are then submitted by bureaus chiefs to departments or ministries heads and, final allocation decisions are made by OCEPRE.

At the beginning of the budgetary process it is also necessary to forecast some macroeconomic variables. The macroeconomic projections underlying the budget are the exclusive responsibility of the Executive, including that for oil revenue, which normally accounts for more than half of the total fiscal income. Based on the macroeconomic projections made by CORDIPLAN and Ministry of Finance, the OCEPRE determines the global level of expenditure that 'should' be afforded without adverse macroeconomic implications, given the expected revenues and the level of deficit that can be safely financed. However, there is evidence that in practice governments have developed a systematic strategic use of macroeconomic forecasts, which mostly respond to a set of different political and economic incentives given the existing conditions at the time. The significant deviations (both upwards and downwards) from the prevailing ranges of such variables could not only be explained by the argument of miscalculations. This perception of a strategic use of forecasts is normally confirmed ex-post budget approval, when the actual impact and implications become evident in the execution stage. For example, regarding of oil price projections, there have been cases of over or under estimation, such as in the years 1998 and 2004 (table 5). In 1998, given the low level of oil prices the

over estimation of the Venezuelan oil basket responded more to the implicit fact that the government was trying to reduce the gap between fiscal income and expenditures. As for 2004, in the context of a very high oil prices the under estimation of oil basket evidenced the Executive's strategy of reducing the level of projected fiscal income as to channel the real income difference through processes that usually allow for a more discretionary use of such extra funds (e.g. supplementary budgets).

Equally, during the period 1994 - 2004 in the majority of cases economic growth has been systematically exaggerated, inflation underestimated and, with the exception of periods under exchange rate control, the projected exchange rate has been consistently below the real rate.

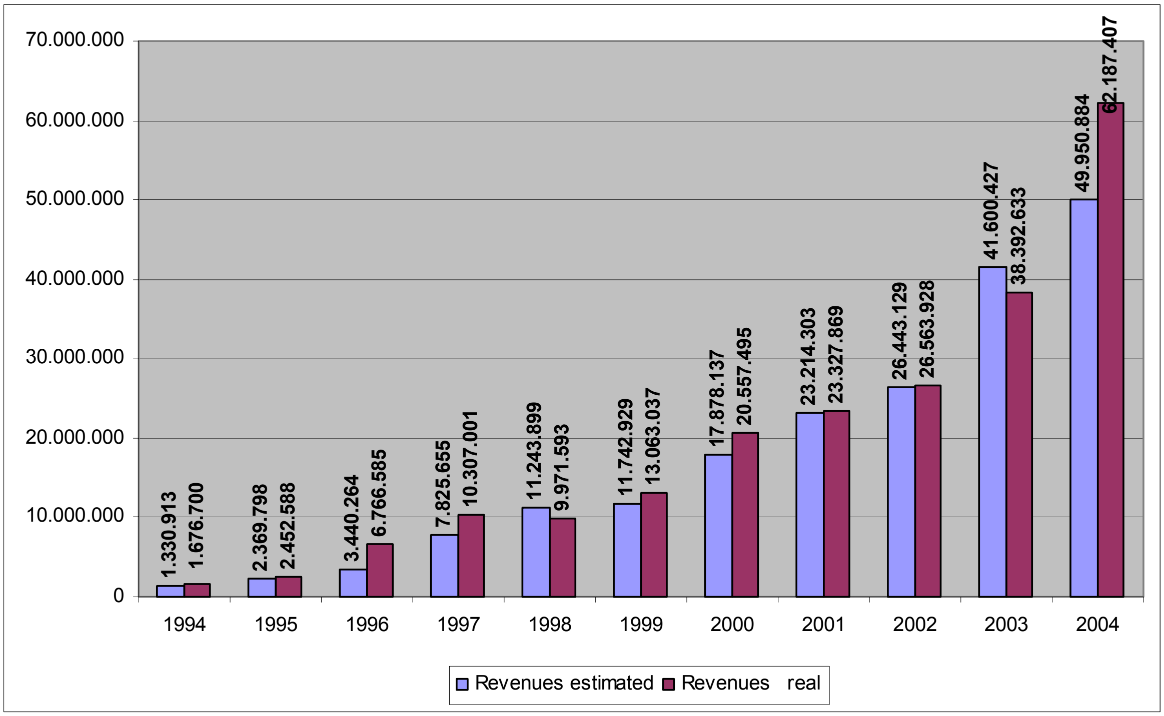
Table 5. Estimated and Real Macroeconomic Variables 1994-2004.

YEAR	Gdp rate of growth (%) estimated	Gdp rate of growth (%) real (BCV)	Inflation (%) estimated	Inflation (%) real BCV	Exchange rate Bs./US$ estimated	Exchange rate Bs./US$ Real/final	Oil prices (US$/bl) estimated	Oil prices (US$/bl) real	Revenues estimated	Revenues real
1994			26,0	70,8		170	15,00		1.330.913	1.676.700
1995	0,00	4,00	20,0	56,6	180,00	290,00	12,00	14,71	2.369.798	2.452.588
1996	2,00	-0,20	28,0	103,2	465,00	476,50	13,50	13,50	3.440.264	6.766.585
1997	4,00	6,40	25,3	37,6	472,00	504,25	14,00	14,00	7.825.655	10.307.001
1998	5,50	0,29	15,0	29,9	546,00	564,50	15,50	10,57	11.243.899	9.971.593
1999	2,80	-5,97	20,0	20,0	638,00	648,25	12,50	16,04	11.742.929	13.063.037
2000	2,20	3,69	17,0	13,4	697,00	699,75	15,00	25,91	17.878.137	20.557.495
2001	4,50	3,39	11,0	12,3	725,00	763,00	20,00	20,21	23.214.303	23.327.869
2002	4,10	-8,90	10,0	31,2	770,00	1401,25	18,50	20,80	26.443.129	26.563.928
2003	3,70	-7,70	28,6	27,1	1.602,00	1600,00	18,00	25,76	41.600.427	38.392.633
2004	6,54	17,9	26,0	19,2	1.920,0	1920,00	20,00	33,1	49.950.884	62.187.407

Source: Ocepre and BCV. Own calculations.

For example, the Venezuelan Congress approved the 1998 budget in December 1997 under the assumption that there would be: (i) 5.5% economic growth; (ii) US$ 15.50 average oil price; and, (iii) 15% inflation. These assumptions appeared to be overly optimistic, given that economic growth during 1998 was actually an economic contraction of 0.3%, oil prices were only US$ 10.57 and inflation was double than forecasted. Similarly, in 2002 macroeconomic forecasts also reflected significant under and overestimations relative to real values. The budget approved assumed a 4.1% economic growth, US$ 18.50 average oil price and 10% inflation, while the economy experienced an 8.9% contraction, average oil prices reached US$20.8 and inflation was three times higher reaching 31.2%.

Figure 1. Real and Estimated Fiscal Revenues. 1994.2004



Source: Ocepre

The commonality in all these periods is that politics has accounted for a significant part of the problem and the process has not been completely technical and objective. Indeed, the lack of transparency and the possibility of manipulation using, in the majority of cases, overly optimistic economic projections have allowed political interests to become a factor in the budgetary process.

In general, these forecasts are not presented with sensitivity or risk analysis, they are not subject to public validation, and they usually differ from market expectations. This suggests that governments have used forecasts strategically. Besides being used for budget projections, macroeconomic forecasts by the government affect the expectations of economic agents. Therefore, a plausible additional explanation for this behaviour would take into account the differing goals of the government regarding both budgetary and macroeconomic goals and the influence of forecasts on private expectations (Abuelafia et al., 2005).

In many years, and especially in the strong recession years of 2002 and 2003, the government had incentives to try to influence expectations by announcing high growth forecasts. In years in which the macroeconomic models at CORDIPLAN predicted negative growth, political authorities insisted on presenting positive growth forecasts. Furthermore, given the budget restrictions of these years, the Executive required high growth and revenue forecasts so as to be able to present a budget without proposing spending cuts to Congress. These required cuts could easily be implemented later in the budget implementation stage. Hence, both political convenience and economic incentives promoted a systematic overestimation of growth in these years.

Equally, as Figure 1 shows between 1994 and 2004, the forecasts in many years underestimated the total revenues of the national government. Total revenues forecasts during 2001 and 2002 were close to real, but still underestimated. This general trend was reversed only in 1998 and 2003. Particularly, in the year 2003 the total resources were overestimated by around 20% despite lower forecasts of oil prices, but the economy experienced a strong economic contraction partially attributed to the lagged

effects of the unpredictable national strike at the end of 2002. In 2004, revenues and average oil prices were again underestimated, and though actual inflation was for a second consecutive year below than expected, it was one of the few years in which economic growth surpassed expected growth, and by a significant difference.

Moreover, optimistic revenue projections, particularly the non-oil fiscal income, have proved equally significant and a key strategic component of the politics behind the budget process. Changes in the incentives for under or over estimation of such revenues have been strongly influenced by the overall economic context and political environment, and have normally been subject of debate within the government. During the 90´s, in a scenario of low levels of oil prices, the most common trend was the overestimation of non-oil fiscal income despite the consistent evidence of a lower collection capacity from SENIAT. Among the reasons for such optimistic projections was to show a smaller gap between ordinary revenues and expenses, especially given the tendency of Congress to cut the budgeted debt level requirements.

More recently, a new practice has been developed. The government has incentives to be optimistic in the forecasting of extraordinary revenues and pessimistic when estimating ordinary revenues. The reason for this is that if ordinary revenues are relatively low as compared with extraordinary revenues, the government, by law, could transfer fewer resources to local administration given that the transfer is a fixed proportion of ordinary revenues.

It is important to note, as was mentioned before, that oil and non-oil revenue projections are prerogatives of PDVSA and SENIAT. Therefore, instead of OCEPRE influencing revenues, revenues have influenced OCEPRE's actions.

When the macroeconomic projections and the main limits of socio-economic policies based on the forecast of PDVSA and SENIAT are defined, a first draft of the ordinary fiscal income of the budget is made. From this income is derived the calculation of the legal assignments. Equally, with this information the first estimates (pre-quota) of ministries and other offices of the public administration recurrent expenditures are carried out.

Box 1. Budget rigidity

Rigidity of the central government expenditure has been another characteristic of Venezuelan public budgets during the last decades. An important proportion of the public spending corresponds to the 'Legal Assignments' which constitute commitments set down in the Constitution and in the legislation which earmark many revenues for specific purposes.

In addition to legal assignments there are another component of rigidity given by salaries and wages and debt service. Even though these expenditures are not considered officially legal assignments, they are "contractually" and "politically" impossible to reallocate. This imposes a considerable constraint on the central government's overall fiscal effort. Since sub-national governments have not fully used their powers to collect taxes, a large share of their revenues (close to 100%) comes from the central government, making them dependent on the intergovernmental transfer. In these circumstances, the government's discretion to reorient the expending according to public policy priorities is seriously limited.

Aggregation of legal assignments, salaries and wages and debt service are shown in table 1. They represent an approximation of the budget rigidity. For example, these expenses reached 55.7% of the total revenues in the budget of the year 1999, leaving available to the Executive Bs. 6,445,776 million to orchestrate a coherent budget policy connected with the strategic guidelines of the State[18].

In particular, the Venezuelan system of transfers to the states is mainly composed of the *Situado Constitucional (*Constitutional Fund), the Law of Special Economic Assignments (LAE) and the Intergovernmental Fund for the Decentralization (FIDES). The first allocates the Central Government's ordinary revenues (according to the law, it should be located between 15 and 20% of these revenues excluding the royalties of hydrocarbons). The second redistributes royalties (with a minimum of 20% of the central government's revenues) that should be assigned to states in 70% where oilfields are located. The third is a pool which is integrated with budgetary contributions. In turn, the states should distribute a specific mount of the resources that are received by the municipalities.

It is estimated that about half of sub-national government revenues are oil-related. By the mid 1990s an important percentage of the oil revenue (regardless of international prices) had been earmarked for transfer to local and regional governments. As explained above, the transfer system tied government revenue to sub-national entities through complex rules, creating a national arena for competition over rents. Under political pressure, based in part on widespread expectations about future oil revenues, governments ignored standards for transfers, and allotted them to states without adequate capacity, whilst the transfer of responsibilities to sub-national governments lagged far behind the transfer of revenues. Furthermore, earmarking has reduced the budgetary flexibility of the central government,

[18] Heavy reliance of states on intergovernmental transfers can create a wedge between local spending and local resources, and between benefits of government programmes and the cost to local taxpayers, which may generate moral hazard (OECD, 2001:43). In Venezuela, states' own resources account for no more 2 or 3 % of their total budgets. Moreover, the use of transfers reduces accountability in expenditure management at the regional and local level of government, unless the transfers are in the form of block grants or involve co-financing. Follow-up and control mechanisms have been developed; but states' administrative and fiscal capacities are uneven and in some states they may be insufficient, which also weakens fiscal accountability. Two key questions arise in this context: whether fiscal decentralisation may lead to a deterioration of sub-national finances, and whether such an occurrence would affect negatively the budget position of the central government. In the event of financial difficulties, the central government would have to bail out sub-national levels of government as in the recent cases of Brazil and Argentina.

locking in spending increases during oil windfalls and forcing drastic cuts in operating expenditures during downswings.

In the Venezuelan case, the inertia and rigidities of budget allocations can be explained as the direct product of high-growth budgeting and the strategy of some groups to protect their 'rent' in the next budget. In the thirteen years period from 1991 to 2004 expectations of high budget allocations became institutionalised in budgetary decision making through the legal assignments (Table 1). Each year new programmes were authorised, usually at low initial levels, in the expectation that future resources would be sufficient for them to grow. Government employees and those receiving benefits from the budget grew accustomed to large annual increases (or at least the same level in real terms), eventually coming to see them as a matter of right (for instance, *política habitaciona*[19] and *Situado Constitucional*).

Interest groups and their allies within the government became sensitive to any suggestion that their particular policy sectors might be viewed less favourably than others, and stood ready to defend themselves against declines in their shares. Thus with time larger proportions of the annual increment (especially oil revenues) came to be 'frozen' and used up by expenditures which were mandatory.

Table 1. Budget legal pre-allocations

Legal Pre-Allocations	
Item	Source of Finance
Situado Constitucional	20% ordinary fiscal income
Fondo de Prestaciones Sociales	1% ordinary fiscal income
Rectifications	0.5% - 1% ordinary fiscal income
I.V.S.S.	1.5% of the total salaries paid by the Public Administration
SENIAT	3% – 4% income administrated by SENIAT
FIDES	15% - 20% of fiscal income from VAT
LAE	24% of the Oil Regalia
Ley de Politica Habitacional	5% Ordinary income discounted *Situado Constitucional*
System of Justice	Maximum of 2% of the ordinary fiscal income

Source: Puente, 2005

[19] Means "housing policy".

Table 2. Budget rigidity. Legal and contractual pre-allocations, 1991-2004 (Million of bolívares)

CONCEPTO	1991	1993	1995	1997	1999	2001	2003	2004
LEGALS AND CONTRACTUALS	**344.450**	**457.910**	**1.315.598**	**4.654.602**	**6.410.018**	**10.932.879**	**21.624.394**	**24.315.979**
. SITUADO CONSTITUCIONAL	106.217	166.132	434.310	1.777.957	1.852.070	3.166.316	4.890.639	7.488.181
. FONDO INTERGUB. PARA LA DESCENT.	0	962	10.528	292.456	473.992	602.872	855.628	1.356.765
. ASIGNACIONES ECONOMICAS ESPECIALES				69.533	271.906	587.172	1.120.690	1.774.550
. LEY DE POLÍTICA HABITACIONAL	25.751	15.066	86.057	257.151	246.888	521.795	970.914	
. FONDO DE PRESTACIONES SOCIALES	4.248	8.503	21.310	65.000	56.564	57.949	242.729	
. F.I.V.		11.500						
. IVSS	4.275	7.316	8.266	9.919	43.170	73.086	220.872	
. INCE		571	483	0	0	0	0	
. SENIAT	0		14.448	32.518	112.000	237.616	368.437	
. SYSTEM OF JUSTICE						305.897	542.811	748.818
. BUDGET RECTIFICATIONS	5.930	5.909						
. DEBT SERVICE	198.029	241.951	740.196	2.150.069	3.353.427	5.380.177	12.411.674	12.947.665
SALARIES AND WAGES	**128.677**	**203.283**	**378.603**	**1.211.401**	**1.702.023**	**3.590.441**	**6.283.752**	**9.580.552**
TOTAL RIGID	**473.127**	**661.193**	**1.694.201**	**5.866.003**	**8.112.041**	**14.523.320**	**27.908.146**	**33.896.531**
BUDGET	801.257	1.100.718	2.808.188	10.667.554	14.557.817	28.079.215	41.613.125	60.505.058
TOTAL FLEXIBLE	328.130	439.525	1.113.987	4.801.551	6.445.776	13.555.895	13.704.979	26.608.527
% TOTAL EXPENDITURE RIGIDITY	59,0%	60,1%	60,3%	55,0%	55,7%	51,7%	67,1%	56,0%

Source: OCEPRE

Furthermore, politicians in general have a tendency to worry more about immediate problems than long-range considerations. In consequence, they can be tempted to adopt dubious budget devices in the short-term. For example, the allocation for the System of Justice, created in the 1990s, would inevitably lead to a report calling for more money within the next years or a new agency or government office might be approved. Similarly, expenditure hikes might be carefully scheduled. In 1992 a legal assignment for the Venezuelan Institute of Social Security (*Instituto Venezolano de los Seguros Sociales,* IVSS) was timed to start so that it would cost only 5.550 million bolivars in the first year, but thirteen years after this programme it cost 748.818 millions (Table 2). Legal assignments, may also seen as an unintended consequence of adaptation to the environment of high expectation from specific groups and the necessity to protect their 'rent' in future budgets.

In parallel with such macroeconomic projections, CORDIPLAN and the Public Credit Office of the Ministry of Finance elaborate the first version of the Law of Indebtedness for Programmes and Projects (*Ley Paraguas*)[20], remitting them to OCEPRE in order to incorporate them in the estimates of budgetary spending. To do this, the Ministries are required to submit a list of projects that will require external funding. Based on the obtained results, a first estimate of budgetary necessities is made and their possible financing sources. After this process the document goes for internal and external discussions in order to balance the budget. The macroeconomic variables are also revised, obtaining a definitive version.

In coordination with CORDIPLAN, OCEPRE revise the first version of the Annual Operating Plan and the *Exposición de Motivos* of the budget. Following this stage, new estimates of the ordinary revenues (and their corresponding legal allocations) are carried out and the estimates of pre-quotas

[20] From 1999 this process has been rule by the new legal framework (LOAF). For more details see section "Budget-making process under the new regulations of 1999.

approved are revised. All public institutions are consulted about the programmes and other actions that they project to carry out during the budgetary period, which are reflected in their respective Institutional Annual Operative Plans (*Planes Operativos Anuales Institucionales*).

During this part of the process, the analysts in the OCEPRE hold budget-review sessions, in which agency heads, accompanied by their staff, defend their budgets' structure and size against the probing of analysts. The often-excessive first round creates the need for a bargaining process to revise the proposed aggregate back downward to a level similar to fiscal income. Such bargaining traditionally involves each public agency and ministry in fighting the OCEPRE to reduce cuts in the level of spending that the agency propose for itself above and beyond the OCEPRE. This process of negotiation and budget rearrangement is necessary to make agency-budget estimates consistent with presidential and departmental policy. The major resource of most ministers and head offices is their own ability to convince the Finance Minister or the OCEPRE's analyst of the soundness of his agency's proposal, and the only reliable appeal is to the President. When resorted to, presidential interventions with Finance Minister are usually based on prior commitments that the Ministers individually extract from the Presidency or on public positions to which the President pledges the administration (Bigler, 1976: 4).

Spending departments tend to press for a larger expenditure whilst OCEPRE urges restraint. Spending departments' attitude is not necessarily discreditable. Officials who are carrying out a programme are likely to be keenly aware of further needs and less sensitive than the OCEPRE to other demands and limitations on the total fiscal income. Agencies can inflate their request in order to leave room for cutbacks. This is where the OCEPRE usually follows the practice of reducing all requests, regardless of how well they are supported[21]. The result can be highly unrealistic requests and arbitrary reductions that negate careful considerations of requirements. In consequence, public offices lack the incentive to tell the truth because if they request the 'necessary' amount of money they would have less than they really need. The outcome is a 'game' where budgets are willingly and commonly inflated.

During this part of the process the OCEPRE budget analysts are also in close touch with the agencies. A large part of their job entails understanding the agency programme and its budget needs. The analysts help to shape the agency budget before it gets to the OCEPRE, to enhance programmes that the Executive desires, or the analyst 'thinks' are in line with Executive priorities. As it was above mentioned, in this stage the OCEPRE's analysts have some discretional power influence over the final budget.

It is also worth mentioning that some public offices may well have information in hand to justify cuts in expenditure. However, there is little incentive to make this information available to OCEPRE. Better to absorb their share of the cuts like everyone else than to see their office programme lose more than the others. As Aaron Wildavsky (1987) observes: "If a [public office's] loss is [another office's] gain, why should [it] play this game?" Equally, for managers of the public offices it is vitally important to protect the office's budget. Even ministers are expected to defend the ministries' money allocations in cabinet or in the OCEPRE, otherwise they could loose credibility within the Ministry or even his colleagues. By design, then, the Venezuelan budgetary process produces a climate of scarcity in which the success of those who participate is measured by the number of bolívares they are able to win.

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[21] At the same time, and in practise, the budget office normally cedes to the public offices the responsibility for detailing the manner in which the funds will be spent, while it instead focuses on the overall sum of expenditures that an entity will be allowed (Jones, 2001: 159).

Another tactic often adopted by public offices when asked to propose economies or reduction in their budgets is to suggest the elimination of a specially popular or prominent programme in order to divert attention from more vulnerable ones. If, for example, the Ministry of Education is asked how it would absorb a budget cut, it may reply that some school would have to be closed, without conceding that any savings in administrative or bureaucratic spending could be made.

In this stage of the budgetary process there is also a strong tendency for public offices to utilise the previous year's budget as a base, normally increasing programme percentages (incremental budget) in line with the limits prescribed by OCEPRE. Thus, when preparing their budget requests, ministries and other public offices often only add percentage increases, guided by an inflation projection, to their previous year's budget.

Budget allocations, however, are by no means final. Many public agencies have strong linkages to Congress and political parties represented there, and are willing to allow the OCEPRE to make cuts, in the anticipation that they will ultimately be restored by Congress in the approval stage of the budget.

The report on the budgetary policies that will govern the exercise, and the estimates (pre-definitive) of budgetary revenues (ordinary, extraordinary and financing), legal assignments, recommendations of ministerial quotas and Indebtedness Law are then presented to the Economic Cabinet for deliberation. Later on, they incorporate modifications and present a definitive version of revenues estimates, ministerial quotas and budgetary policies to the Council of Ministries for approval. Once approved this is remitted officially to the corresponding institutions in such a way that they elaborate its budgets and remit to OCEPRE. The OCEPRE then revises and consolidates each budget. Concurrently, the final versions of the *Exposición de Motivos*, the Annual Operating Plan and the Indebtedness Law are prepared.

It is important to note that time constraint is a central factor in explaining regularly inconsistent budgets. The reduced time in the formulation of the budget (partially a consequence of overlapping phases) and the difficulties of programming for more than one year directly limit the deliberations between the budget office, the ministries and public offices. For example, during the preparation of the 1997 budget, most ministerial offices had only three days to discuss their proposals (Petrei, 1998: 319). This is the reason for the final reconciliation of the budget in OCEPRE being popularly known as the *madrugonazo*[22].

The final version of the budget during the Executive phase is approved by the Council of Ministers and submitted to Congress by the Finance Minister at the beginning of the Congressional budget session. This draft version of the budget immediately goes to the Finance Committee of the Chamber of Deputies, which holds primary responsibility for revenue and expenditure bills. Specifically, Article 22 of the Organic Budget Law (LORP)[23] which governs the Executive's budget, specifies that the President has to transmit the budget to Congress during the last two weeks of June for the following fiscal year, which begins 1 January.

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[22] In other words, OCEPRE officials are going to spend the whole night reconciling the budget just a few hours before its submission to Congress.

[23] See box 2 on "Budget-making process under the new regulations of 1999".

Congressional approval stage

This phase consists of the passage through Congress of the budget law, up to its final approval. In particular, with the budget submission, budget responsibility falls on Congress. This body has a Constitutional mandate and primary responsibility for matters of government budget, and legislative action on the proposed budget begins at the Finance Committee. This committee is organised into 13 subcommittees, each of which has responsibility for a particular kind of proposed expenditure (AVPP, 1995: 222). Each subcommittee holds hearings on a portion of the budget for which it is responsible and develops an appropriation bill containing its recommendation. These bills are then reported to the full committee, which pass them, in some cases making modifications. The full committee, in turn, reports the bills to the whole Chamber of Deputies (until 1999 when it was still bicameral), where they are approved usually after amendments.

The Chamber of Deputies must pass the budget before any formal Senate action may be taken. However, many Senators informally join the Deputies committee's deliberations to form an effective joint committee. Otherwise, they would have only a few days to debate and decide on the budget. Following the passage of the budget by the Deputies, the Senate goes through a similar subcommittee-committee-full membership process. If the Senate rejects certain proposals, a joint meeting is held. During the debate the legislature could change priorities and add or cut public works. With the approval of both houses, the appropriations legislation goes to the President for his signature. This process must be completed before November 30th (Article 25 LORP). If Congress does not approve the proposal, the Executive branch puts a default budget into force. However, if Congress produces an agreement before March 31st of the current year, the new budget is then valid.

The Executive retains an early advantage even as Congress begins the public review of the budget proposals. Within the first weeks of submission the Ministry of Finance, OCEPRE's director, the President of PDVSA and the director of SENIAT appear before the Congressional Finance Committee. In the majority of cases they have been reported by the press while the Congressional questioner has been largely ignored; the press tends to focus on the administration witness and not on the legislative interrogators. Legislators may be seen welcoming the ministries and the budget director to their committees and subcommittees; nonetheless, the momentum lies with the Executive officials.

Executive implementation stage

This stage refers to the execution of the budget, which utilises legal spending authority. It includes commitments, such as contracts or other obligations for hiring personnel, purchases of goods and services, disbursements, and recording and reporting. One aspect of particular importance at this stage is how much flexibility there is in the budget to face unforeseen contingencies. This is fundamentally related to the possibility of introducing supplementary budgets during the fiscal year and the ability to transfer resources between budget chapters, programmes and ministries. According to these criteria, as will be detailed later in this document, Venezuela's budget is very flexible in the practical sense at the implementation stage (despite that the formal rules might establish a more rigid procedure fundamentally in the formulation stage). In consequence, the budget tends to be subject to important changes during its implementation.

In particular, if revenues fall short of expectations or delays are experienced in spending during the budget execution stage, OCEPRE may defer or cancel part of the authority of operating offices. Conversely, if government finds that it needs to spend more money than Congress originally allocated for the budgetary year, because of circumstances that were 'not anticipated' when the budget was formulated, additional allocations are enacted. Further funds might be needed in order to provide adequate assistance to an area afflicted by varying factors. Under such circumstances, the Legislative

may enact supplementary budgets that become a channel for fiscal indiscipline as they are less carefully scrutinised in Congress than the initial budget approved.

An important feature of the budget execution until 1999, is that expenditures committed in a fiscal year can be paid in the first semester of the following budgetary year (complementary semester) through the remaining credits account, created toward the end of each year (Petrei, 1998: 321). Then, the Venezuelan budget has 12 months' revenue and 18 months' expenditures which creates all the incentives and conditions to spend more than income available. After the new Public Finance Law (LOAF), this complementary scheme was eliminated.

Finally, it must be mentioned that the formal and informal rules of the Venezuelan budget give public offices a strong incentive to spend all available resources, even at the expense of efficiency. The disincentive to be efficient is summarised in the 'use it or lose it' attitude of public offices. Public institutions routinely assume that if they do not spend their entire budget, they may be given fewer resources the following year because spending units cannot retain unused public funds. Thus, the institutional framework in the execution process of the Venezuelan budget creates all the incentives to spend more rather than less.

Box 2. Budget-making process under the new regulations of 1999

The 1999 Constitution established the basis of the new budget-making scheme (Articles 311-315) and it incorporated a long term view mainly based on a multi-year scheme (Plurianual), in which ordinary incomes must be sufficient to cover ordinary expenses, aimed at reaching fiscal balance during the set period and within the macroeconomic and fiscal agreements among government institutions. It is stated in the Constitution (Article 313) that from the presentation of the multi-year framework, the special indebtness law and the annual budget, the Executive will make explicit long term objectives of its fiscal policy´s long and explain how these objectives will be reached within the principles of responsibility and fiscal balance. From this foundation, a set of new laws and norms where approved since the year 2000.

In September 2000, the Organic Law of Financial Administration of the Public Sector (Ley Orgánica de la Administración Financiera del Sector Público - LOAF) was enacted, incorporating the different administrative and financial procedures required for budget-making, public credit, national treasury, accounting and internal control that were previously in different laws. From the integrated view established in this law, separate normatives were approved for each case. The first normative is related to the budget process (Reglamento No1-LOAF), the second to the public credit operations and the third for treasury transactions.

The main innovation in the LOAF was the inclusion of macroeconomic and fiscal rules in order to articulate the yearly budget to the long term fiscal targets to guarantee fiscal balance. One of the main objectives is that national, regional and local plans be embedded in the public budget. Therefore, the formulation stage now includes a set of procedures for each case, expanding the institutional coverage of the budget process with differentiating rules applying to the Central Government and its entities, to local governments, and to companies in which half or more of its capital is owned by the State or public entities. Specific laws established more detail, especially at municipal levels, but all within the principles and dispositions determined by the LOAF.

The link between planning and budget had started in previous years, and even a pilot plan was made using the case of the Ministry of Transportation and Communications to show the possible

effectiveness of such proposal, but it is not until the new legal framework set by the LOAF that the linkage and mandatory execution of planning and budget is made more explicit.

The new fiscal balance rules for macroeconomic planning established some main conditions, among which it includes: a balance or superavit between ordinary revenues and expenses; fiscal adjustments needed to meet the balance target must not be concentrated in the last year of the multi-year period; the maximum limits defined in the rules for spending and debt must be based on an estimation that should incorporate the requirements of fiscal sustainability, size of the economy, reproductive investment and fiscal capacity; variations to the spending and debt level established will only be approved for exceptional cases; the Executive Branch must present to the National Assembly, before July 15 of each year, a report with the evaluation of budgetary executions and explanations for any deviations from estimated amounts.

The complementary semester scheme used under the previous budgetary framework was eliminated, thus no new compromises or expenditures are allowed after December 31 of each year. Any spending compromised not executed by that time is to be transferred to the next year's budget.

With all this in mind, the new laws and normative developed all the operative details for the multi-year budget making scheme with a time horizon target of 3 year, during which the estimated amounts for those years are to be spread annually in such a manner that they do not exceed the pre-set limits for the whole 3 year period. A specific year imbalance is allowed as long as the overall 3 year horizon limit is kept. The multi-year budget must be prepared by the Ministry of Finance in coordination with the Ministry of Planning and Development and the Central Bank (BCV).

The LOAF incorporates penalties and sanctions to ministers that deviate from the rules and targets established in their multi-year budgets, as well as sanctions and destitution of other public officials.

As from 2003, pre-assigned fiscal incomes were derogated, which limits the real application of laws such as Fides and the Law for Special Economic Assignments (LAEE) and to be started in 2005, but did not start until 2006. The stipulated original starting period for the Multi-year budget making scheme was 2005, but it was delayed until January 2006.

New Laws Old Practices

The way the budget is elaborated and implemented has not changed much in recent years despite the approval of new laws. The main objective of the 2000 Organic Law of Financial Administration of the Public Sector (LOAF by its acronym in Spanish) is to regulate the following aspects: the financial administration, the internal control mechanisms of expenditures for the public sector, the macroeconomic coordination between the Central Bank and the Finance Ministry, the Macroeconomic Stabilization Fund (FIEM by its acronym in Spanish), and the Intergenerational Saving Fund. Together with the implementation of multi-years budgets in order to keep an inter-temporal balance, this law also formalized the annual signing of a macroeconomic policy agreement between the Central Bank and the Finance Ministry.

However, this law has been never fully adopted and the budgetary process has not changed significantly since its approval. For example, although in 2003 the first macroeconomic policy agreement was signed, it was dismissed almost immediately on grounds of an adverse economic situation. Moreover, the multi-year budget supposed to be put in place by 2005 was postponed until January 2006. This is a clear example of a modern and formal budgetary rule that is not binding of the budget process.

Another example is the FIEM, which was established in 1998 in an effort to stabilize the volatile oil revenue. Nevertheless, this law has been modified already four times to accommodate the fiscal needs of the government, losing its credibility and stabilization power. Also, recently a new Central Bank Law was passed. Basically, this law permits the Central Bank to transfer "excess reserves" to the government that could be spent in infrastructure projects and debt repayment. This revives the practice of deficit financing by the Central Bank which was very common during the seventies and eighties.

In summary, despite new laws such as the LOAF and the FIEM informal budget rules are still in place. In addition, the new Central Bank Law is just a comeback to practices that past experiences and economic literature have both proven that their application fuels inflation and causes macroeconomic instability.

Evaluation and control stage

The evaluation and control of the national budget is the responsibility of OCEPRE. This office has assigned the role to follow up the execution of the budget regulations and, if necessary, conduct investigations regarding any violations to the legal framework by public officers, as well as suggest sanctions to the appropriate institutions. All ministries have their own comptroller offices that review internal accounts, and all the public sector institutions must follow internal control procedures established in the law. It is the Internal Audit Agency (*Superintendencia de Auditoría Interna*) which has auditing power over all public sector institutions, with the exception of the Venezuelan Central Bank. The external control responsibility relies on the State's Office of the Comptroller General, which carries out the oversight of any operations related with public sector revenues, expenditures, as well as public and national goods. It enjoys organizational, administrative, and functional autonomy, and is in charge of the inspection of agencies and entities under its control. Nonetheless, despite an extensive regulatory and control framework, the fact that in practice little is applied and enforced provides a clear indication of lax or inexistent control system of the budgetary process.

VI. Budget amendments in the approval and implementation stage: an empirical assessment

This section quantifies the Executive's proposed budget and the final budget allocated and executed by the government during the period 1973-2004. Particular attention is paid to changes in specific years, programmes and areas of the budget. This serves to present additional empirical evidence about the pattern of interaction between the main actors in the budget-making process[24]. In particular, the aggregate differences between Executive budget proposals and the final legislation approved and executed illustrate four important points: First, Congress, even without altering the overall spending levels, has altered the composition of spending proposed by the Executive in the approval stage of the budget. Two, consistent with the analysis made in this work, the empirical evidence presented serves to identify two different patterns of congressional activity in the period 1973-2004: two periods (1973-1985 and 1999-2004) characterised by a relatively low level of congressional involvement in the budget process and a third period by a high level of involvement (1986-1998). Third, the high number and

[24] This section's analysis derives from primary data aggregated for the study; however, it is also drawn from interviews during the fieldwork in Caracas with several former members of the Executive and Legislative branches (Puente, 2005).

level of supplementary budgets have contributed to the erosion of the budgetary discipline, congressional fiscal controls and have increased spending. Four, it shows evidence about the power of specific interest groups in the Executive-Congress budget-making process.

This section is structured as follows: the first section quantifies the changes in the budget level and composition in the approval stage by public office and year. It also presents evidence on the three sub-periods identified in the budget-making process through 1973 and 2004 and gives some political and economic explanations for the high and low levels of congressional activity during this period. The last section explains and quantifies the budget amendments in the implementation stage, with special emphasis on the supplementary budgets.

The Executive budget approval in Congress

This phase, consisting of the passage through Congress of the Executive budget law up to its final approval, has three crucial aspects. Firstly, whether the scope of the amendments can, for example, increase spending and/or reduce revenues. Secondly, a more general aspect is the strategic relation between the Executive and the Congress at this stage. Thirdly, how important is the influence of different interest groups on the budget approval process.

In particular, this subdivision of the document is interested in measuring and explaining the percentage of deviation between aggregate spending proposed by the Executive and that approved by Congress. The absolute value of the difference between the President's budget request and the congressional appropriations (calculated as a percentage of the Executive request) is one measure of the distribution of congressional activity. The average annual absolute difference between the President's request and Congress's allocations supplies a useful summary index of congressional activity for the period under consideration. If the Congress has made no changes in a particular budget category or public office in the twenty-six-year period, the index of activity will be equal to 0. Large or frequent congressional changes in the Executive's requests (increase or decrease) will yield larger values for the index (Kanter, 1972: 133). In particular, three measures of congressional activity are employed: Firstly, the increase or reductions in the overall Executive's budget; secondly, the presence or absence of changes in the President's budget by office; thirdly, the average frequency of congressional changes in the different budget items by year. As will be shown, the three measures indicate that congressional activity has been concentrated in particular budget categories and years.

As table 6 shows, the aggregate spending level of the budget law was on average –1.3% percent of the initial executive proposal for the period 1973 to 1985 and 5.8% for the period 1986 to 1998. The average percentage of variation of the aggregate spending level across the whole period was 2.3%. From 1973 to 1985 almost all the changes that the Congress made in the budget were reductions, whereas in the rest of the period the majority of changes were increases in the total budget request. Since 1985, the tendency to increase the initial proposal has been higher. For example, in 1986 and 1987, in the Jaime Lusinchi government, the final budget entailed increases of 13.8% and 22.4%, respectively. Whereas, in 1993, 1996, 1997, 2002, 2003 and 2004, the aggregate spending figures for proposals and the final budget were identical.

The fact that the overall spending has been increased or decreased in some cases would appear to contradict Article 229 of the Constitution about the prohibition of congressional amendments in the total spending. As has been explained above, the Venezuelan legal framework allowed for the composition of the expenditure or revenue plans to be changed but not the global total. Thus an important question is, where did the appropriations increases come from, given that Congress was prohibited from initiating them?

At least two factors were at play in the Executive budget increases and decreases, one having to do with budget estimates within the Executive, and the other with inter-office bargaining. First, Article 229 of the Constitution clearly established that the Executive unilaterally determined revenue estimates and that only these figures could be used in budgeting. However, legislators could object to the revenue income because this was usually overestimated. In consequence, in some years they had requested the Executive to update its revenue and spending estimates adjusting its proposed bill accordingly, and even sponsoring some amendments designed to serve the legislator's interest during that time. Similarly according to Article 22 of the Organic Budget Law, the Executive budget proposal was originally submitted in the second half of June. During the following weeks, as fourth-quarter tax receipts and economic projections took shape, the Executive itself inevitably wanted to make changes to fine-tune its budget projections. The systematic bias in the economic and fiscal forecast of the Venezuelan governments increased the necessity for congressional changes in the Executive budget request. Therefore, attributing responsibility to Congress for all alterations in Presidential spending on request under these circumstances is clearly unrealistic.

Consistent with these explanations are the interesting insights into the huge budget decrease of 1977 and the increases in 1987 and 1995, supplied during the interviews by the former Acción Democrática president of the congressional Finance Committee Carmelo Lauría:

> "In 1977 revenues decreased. There was an oil crisis that year, therefore a reduction had to be made. There was a crisis in which the economy overheated. We had a current account deficit of almost 1,500 million dollars and we took the 1977 measures in which we established a series of credit restrictions… in 1987… when the budget was approved it was done based on the estimates made prior to November; in December 1986 the exchange rate was modified and the dollar changed from Bs. 7.50 to 14.50. This caused a re-estimation of the revenue, hence resulting in a 22% increase, since revenue was obtained due to this circumstance. This situation also occurred in 1995; that year's devaluation was in December".

After the submission of the proposal to the Congress, legislators began lobbying for increases as well as enlisting Executive officials to sponsor the necessary amendments, because no legislator could initiate such changes without Executive sponsorship. The ministers and other Executive officials who testified before the Finance Committee were also very influential[25]. Congress could increase or decrease the total spending only with the Executive approval. This was one of the phases of the process where political negotiations between Finance Committee, parties and Executive occurred. Legislators made suggestions and proposals and the Executive proposed them as its own, because Congress could not make changes in the level of total spending. This congressional influence is an additional factor explaining how the final budget bills could appropriate more money than proposals, despite the formal restrictions on congressional amendments (tables 6 & 7).

[25] Direct observation of the Finance Committee members question time (*interpelaciones*) with executive officials during review of the budget proposal in Caracas in 2002 (Puente, 2005)

Table 6. Proposed budget and budget law, 1973-2004

Years	Proposed budget	Budget law	% of change
1973	14,287.7	13,819.4	-3.3%
1974	14,569.2	14,548.7	-0.1%
1975	41,526.4	41,395.7	-0.3%
1976	33,167.1	33,041.5	-0.4%
1977	46,682.8	35,634.3	-23.7%
1978	40,879.7	44,272.8	8.3%
1979	46,540.8	46,340.6	-0.4%
1980	57,076.8	56,685.4	-0.7%
1981	69,994.0	75,743.7	8.2%
1982	87,434.0	86,943.0	-0.6%
1983	77,811.3	76,381.9	-1.8%
1984	77,477.0	77,040.9	-0.6%
1985	103,405.9	102,843.6	-0.5%
1986	107,479.0	122,283.2	13.8%
1987	129,075.5	158,018.9	22.4%
1988	184,101.6	185,122.4	0.6%
1989	183,845.5	183,305.5	-0.3%
1990	419,387.6	443,718.1	5.8%
1991	756,198.9	713,429.6	-5.7%
1992	798,219.1	863,224.0	8.1%
1993	1,105,791.7	1,105,791.7	0.0%
1994	1,330,913.6	1,430,635.2	7.5%
1995	2,369,798.3	2,786,469.0	17.6%
1996	4,104,890.4	4,104,890.4	0.0%
1997	7,825,655.6	7,824,855.6	0.0%
1998	11,243,899.0	11,899,290.0	5.8%
1999	13,943,265,5	13,696,059.0	-1.8%
2000	18,366,037.2	17,878,137.2	-2.7%
2001	22,940,637.0	23,214,303.0	1.2%
2002	26,443,129.3	26,443,129.3	0%
2003	41,600,426.6	41,600,426.6	0%
2004	49,950,883.6	49,950,883.6	0%

Source: Calculation based on National Budget data from 1973-2004.

Changes in budget composition by Congress

Given the unequal prerogatives between the branches of government and data measuring the legislative balance of power between the Executive and the Congress, there is a strong temptation to simply conclude that the Congress was insignificant in the legislative process, as much literature on Latin American legislatures has suggested[26]. In particular, the conventional wisdom that holds that the Venezuelan Congress has been unwilling to address the budget in policy terms could be a consequence of analyses based on highly aggregated data. An exploration within the change in the budget law by individual office or aggregate changes in a year suggests that the legislature has had more impact in some areas than in others and, more importantly, that congressional budget activity has been concerned with more than increasing or reducing the total level of expenditure.

A measure that is able to distinguish budget categories by year or public office in which there were small or infrequent changes in the President's budget, and those in which there were large or frequent changes can obtain a more complete picture. This suggests that the legislature is more influential than a concrete reading of the Constitution, the Organic Law of Budget or the internal laws of Congress would suggest. Therefore, Congress has had a more substantial impact on the budget process than many readers might think, due to both the relatively non-conflictive treatment of the budget in Congress, and the legal and constitutional rules portraying Venezuelan governments as extremely Executive-dominated. This section provides additional evidence, of a noteworthy level, of congressional influence on the budget process during the period 1973-2004.

Table 7 shows the change in budget law by public agency and office as a percentage of the initial Executive proposal submitted to the Congress every year. Some public offices had systematically increased their allocation in the budgetary process in Congress. For example, the National Electoral Council was the component with the highest average variation. This budget increased from 1977 to 1998 by an average of 39.9%. However, it is important to mention that this increase was associated fundamentally with periods immediately prior to electoral years. As Carmelo Lauría, Acción Democrática former Deputy, pointed out in the interviews in Caracas: "…the Executive knew that it could send National Electoral Council's expenses underestimated because the Congress would make the corresponding adjustments…"

In the same line of argument Gustavo Tarre Briceño, a Copei former President of the congressional Finance Committee, comments:

> "The previous law also provided public financing for political parties and the government did not usually include it. That was one reason, the other reason is that there was also an electoral process and the Executive did not make the necessary provision for this, just as is happening now with the referendum. There is no funding in the 2004 budget, hence, there has to be supplementary budgets to pay for the referendum."

The Presidency Office (17.61%) increased its proposals in almost every year. The resources allocated to this ministry had the particularity that they were available and were used to a high degree at the Executive's discretion. Additional insights into the increase of this Ministry are given by Carmelo Lauría:

[26] For a complete analysis of the balance of powers between Executive and Legislative in Latin American countries see Shugart & Mainwaring, 1997 and Payne et al., 2002.

> "…If you make a breakdown of this I assure you that you will find that this 17% is composed of changes in allocations for CVG, CONAC, and CORDIPLAN. The Presidential offices were attached to the Presidency Office which is another of the things corresponding to the President's office according to the law. Besides this you had the development corporations. So, if you analyse this 17% it is the Presidency Office, but the decentralised entities attached to the Ministry. This was the reason why this office was created, to decentralise these entities from the Presidency of the Republic and attach them to a Ministry…"

As has already been explained in the analysis of interest groups, in the 1970s and the first part of the 1980s the Venezuelan state grew rapidly to comprise approximately four hundred entities in the decentralised public administration. These took many legal forms, including state-owned enterprises, autonomous institutes, foundations, credit and finances agencies and regional development corporation (e.g. CVG). They undertook activities in areas as diverse as agriculture, mining, manufacturing and electricity, construction, finance, real state, etc. The independent legal status of these offices of the Decentralised Public Administration gave them substantial degrees of autonomy with respect to income and expenditure (Crips, Levine & Rey, 1995: 154). For example, in 1974, during the Carlos Andrés Pérez government the planned net transfer of budgetary resources to the private sector through public offices was enormous. When combined with CORPOINDUSTRIA for a small and medium sized industry, the Urban Development Fund, for the construction industry, and the CVF, the Venezuelan Industrial Bank and the regional development corporations it reached unprecedented levels (Karl, 1997, 134). Then, during the 1970s and 1980s, an important amount of financial resources was requested in the budget process for these public entities.

Likewise, an important proportion of the external debt was owed or guaranteed by the public sector, including those offices of the Decentralised Public Administration, which lacked adequate control and oversight mechanisms. The lack of control mechanisms by either the Executive or the Congress meant that many state agencies were left free to incur external debt on their own initiative. When attempts were made to institute needed controls, decentralised offices began to borrow from public financial institutions which, in turn, increased their own overseas' borrowing (McCoy & Smith, 1995: 271). Thus, as a consequence of huge amounts of borrowing, the budget allocations to the Decentralised Public Administration in the 1970s and part of the 1980s were even larger.

Not surprisingly Congress itself also increased its budget by more than 16.9% during the study period.[27] As has been pointed out, Gustavo Tarre Briceño in one of the interviews in Caracas in 2003 said: "…everyone asked for much more than they needed in order to later accept cut-downs and the Congress was assigned much less because everyone knew that afterwards it would insure it would increase its budget again…"

Other offices that systematically increased their share of the total budget in the congressional budget approval were the Ministry of Transport and Communications, the Ministry of the Environment, the Ministry of Agriculture, and the Ministry of Defence. Almost every sector increased their share in the budget with the exception of the Ministry of Energy and Mines (-0.97), the Ministry of Youth (-1.06%) and the Ministry of Information and Tourism (-5.19%). According to the evidence, it seems

[27] Certain outlays have been to a significant degree outside the purview of the Budget Office and the Ministry of Finance. Outlays for Congress and the National Court of Justice have been among them, and rightly so, because they have been equal branches of the government. How could they be independent, it has been asserted, if the Executive controlled their money?

reasonable to suggest that the budget decisions relating to the three previously mentioned sectors had commanded relatively little congressional attention.

During the interviews, Gustavo Tarre Briceño makes an interesting point concerning the allocations to the Ministry of the Environment:

> "One of these aspects during the period I participated in [Congress] was a centralist Executive, a decentralising Congress in expenditure matters. Hence, this aspect had great influence in taking away central power and giving it to the States… that explains why, for example, in the Ministry of Environment you have the water companies and can see that the increase in the Ministry is because Hidroven is there as well as the different regional companies, thus explaining why this ministry appears as one of the highest [on the list of supplementary budgets]…"

This distribution of Congress's changes in the Executive budget is consistent with the hypothesis that Congress had a programmatic as well as a fiscal orientation towards particular areas of the budget; namely, its judgments regarding specific programmes and their relation to legislature and party interests, rather than an exclusive concern with reducing spending, eliminating waste or preserving budget discipline[28]. For the Congress, and in particular for the members of the Finance Committee, budgeting was their purpose and one of their powers. For members of the Congress with strong issue preferences, budgetary action could provide power because this stage of the budget process became the target of opportunity for 'rent seekers'. And in particular for leaders of the political parties and influential Deputies, the totals for big programmes in the budget resolutions measure their party's influence on the course of government.

Moreover, with the exception of 1983, 1996 and 1998 (the years of the Copei and the Convergencia governments), the Executive branch achieved the passage of the budget in the constitutionally mandated period. In doing so, it had to take into account the wishes of Congress in the approval stage of the budget to a much greater extent than had been the cases in those years in which the Executive branch had employed the previous year's budget (*presupuesto reconducido*). This factor generated a further incentive to make agreements that benefited the constituencies or groups of interests close to legislators. Like spending ministers, members of Congress could propose amendments that benefited their constituencies or groups of interests, failing to internalise the budget costs associated with these measures.

Thus, the cross-sectional variations in congressional activity support the view that congressional average increases in the President's budget were concentrated in a group of public offices and ministries: the Ministry of Industry, the Presidency Office, the Ministry of the Environment, the Ministry of Transport and Communications, the Supreme Council of Justice, and in a high proportion in the Congress's own budget rather than by equally distributed resources between all public offices (table 7). One may conclude from these results that congressional activity and, inferentially, congressional interest was concentrated on those sectors. Certain budget categories appeared to attract more congressional interest than others. Thus, the Legislative, even without altering the overall spending levels, pressed for redistribution of appropriations across programmes, areas and public offices.

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[28] However, it is important to recognise the possibility that legislature affected constituent welfare in many ways besides the direct allocation of public spending, for example by promoting regulatory, trade and tax policies that were favourable to legislators or party interest.

Table 7. Congressional changes in President's budget requests by public office, 1973-2004

Public offices	1973-1998	1999-2004	1973-2004
National Electoral Council (1977-2004)	39.91%	-8.21%	29.60%
Ministry of Industry (1977-2004)	21.83%	-11.67%	14.65%
Presidency Office (min sec presidencia) (1978-2004)	17.61%	8.73%	15.64%
Congress(1977-2004)	16.91%	3.96%	14.14%
Ministry of Environment (1978-2004)	14.90%	-5.16%	10.44%
Ministry of Transport & Communications (1978-2004)	13.34%	16.88%	14.13%
Supreme Council of Justice	9.31%	0.73%	7.70%
Ministry of Urban Development (1978-1999)	8.37%	-8.61%	7.60%
Ministry of Agriculture (1973-1999, 2003-2004)	7.79%	-9.38%	6.01%
Public Prosecutor's Office	7.46%	1.11%	6.27%
National Comptroller	6.86%	-4.07%	4.81%
Ministry of Family (1973-1999)	6.86%	16.31%	7.21%
Ministry of Justice (1973-1999)	6.69%	2.57%	6.54%
Ministry of Defence	6.13%	0.72%	5.12%
Judiciary Council (1977-2000)	6.05%	-5.02%	5.13%
Attorney's Office	5.07%	-0.27%	4.07%
Ministry of Internal Affairs	3.91%	-1.34%	2.93%
Ministry of Education	3.67%	0.53%	3.08%
Ministry of Foreign Affairs	3.40%	-1.76%	2.43%
Ministry of Finance	2.05%	-3.43%	1.02%
Ministry of Health	1.61%	-1.49%	1.03%
Ministry of Labour	-0.46%	-0.25%	-0.42%
Ministry of Energy & Mines	-0.97%	-11.76%	-2.99%
Ministry of Youth (1978-1987)	-1.06%	0.00%	-1.06%
Ministry of Information and Tourism(1978-1985)	-5.19%	0.00%	-5.19%
Ministry of planning and development (2000-2004)	0.00%	25.82%	25.82%
Ministry of science and tecnology (2000-2004)	0.00%	9.41%	9.41%
Peoples defender (2001-2004)	0.00%	4.26%	4.26%
Vice-presidency Office. (2001-2004)	0.00%	-0.07%	-0.07%
Ministry of universitary education (2003-2004)	0.00%	-0.05%	-0.05%
Ministry of comunication and information (2003-2004)	0.00%	0.00%	0.00%
Moral Power (2004)	0.00%	0.00%	0.00%
National Audit Office (2004)	0.00%	0.00%	0.00%
Recficaciones (1999-2004)	0.00%	-2.12%	-2.12%
TOTAL (1999-2004)	0.00%	-0.54%	-0.54%

Source: Own calculation based on National Budget data from 1973-2004.

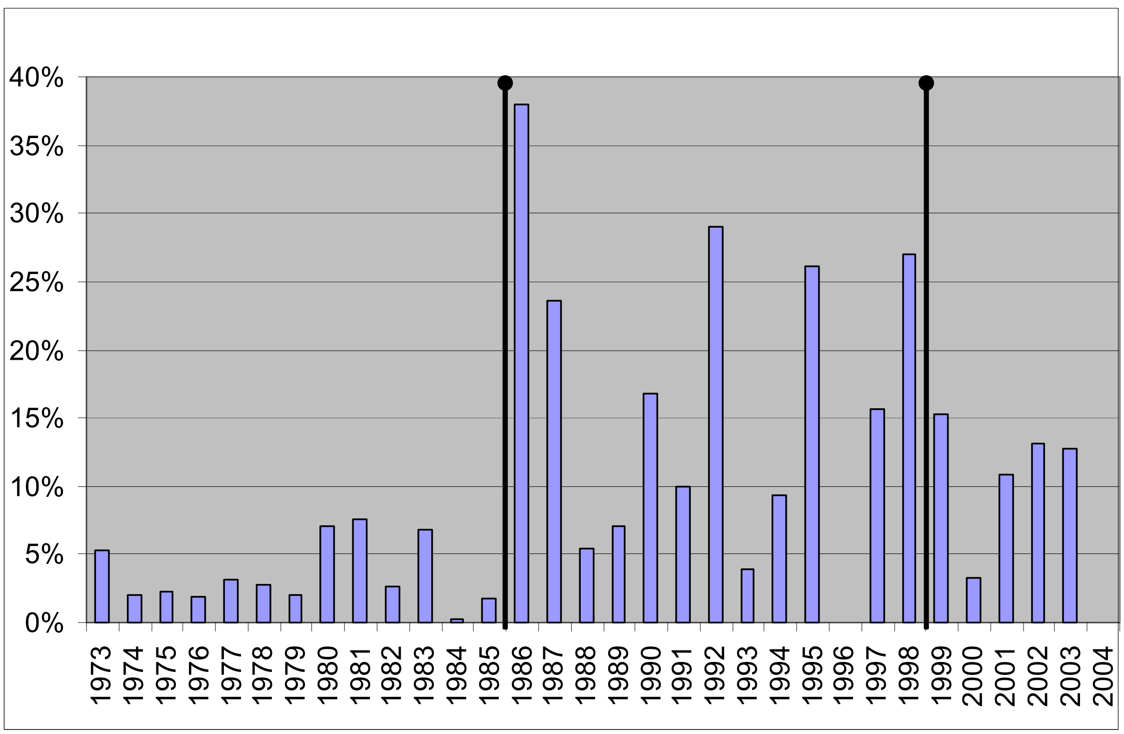
Patterns of congressional activity: some explanations

The interaction between the Executive and the Congress is very important in terms of budget allocations because both political authorities have to approve the budgetary decisions. The question arises as to what happens when both authorities have arrived at different decisions. According to the data, especially during the period 1986-1998, there was no clear consensus between the Executive and the Legislative on how to address the problem. As can be seen in figure 6, congressional activity was relatively high during the period 1986 and 1998 while the periods 1973 and 1985 and 1999 and 2004

were characterised by somewhat fewer or smaller changes by Congress, which is evidence of the fact that Congress accepted and ratified the budget decisions of the Executive.

Interesting also is the aspect that, in those periods, the budget approved by Congress was lower in some years compared with the Executive request. From the fiscal years of 1973 and 1985 all the Congress allocation varied from the Presidential request by less than 5%. From 1986 to 1998, three annual appropriations involved changes of less than 5% percent, six more than 26% and one (1986) more than 36%. When compared to average changes per year since 1986 until 1998 in the budget, congressional alterations or redistributions in the President's budget request were large. Consequently, and consistent with the analysis made above, it is possible to identify three different patterns of congressional activity in the period 1973-2004 (figure 2): two are characterised by a relatively low level of congressional involvement in the budget process (1973-1985 and 1999-2004), and the other by a high level of involvement (1986-1998)

Figure 2. Average Congressional changes by Office in President's budget requests by year, (in absolute terms) 1973-2004



Source: Calculation based on National Budget data from 1973-2004. The average was calculated using the absolute value.

Consequently, the above aggregate figures, especially from 1986 to 1998, somewhat understate the extent to which Executive proposals were amended. In contrast to the vision of an insulated Executive power, the data on congressional activity shows that, on average, more than 20% of the legislative initiatives of the Executive were modified by Congress (amendments to the presidential budget). Even without altering the overall spending levels, legislators pressed for redistribution of appropriations across programmes, areas or public offices. In various ways the budget was formulated to contain 'something for everyone' to ensure passage through Congress and benefit sectors of interest for the legislator (Drazen, 2000: 706).

At least two forms of bargaining were used by the Venezuelan Congress to build majority coalitions to make decisions about budget allocations and, in consequence, to bring about redistribution of resources across programmes, public offices and areas: logrolling and compromise. Logrolling was an exchange of voting support on different budgets by different members of Congress. It was an effective means of coalition building because members were rarely equally concerned about all the public spending distributional decisions. Second, compromise, unlike logrolling, built coalitions through negotiation over the content of legislation. Each party agreed to modify policy goals on a given bill in a way that was generally acceptable to the other. A middle ground was often found. For example, if Acción Democrática supported a public programme in education for 50 million and Copei wanted to increase the allocation to 100 million; the parties would be expected to meet and compromise on a 75 million allocation, a middle point between both requests.

Likewise, an intermediate position usual in the Venezuelan political system was 'negotiate support'. The ruling parties, Acción Democrática and Copei, supported the Executive in return for some concessions, such as granting legislators "a seat at the policy table", which translates into allowing legislators to scrutinize and modify bills (Corrales, 2002: 12).

Explanations for the dramatic change in congressional activity observed may be divided into two general classes: firstly, considerations of domestic politics reflected in Presidential and congressional budget-making processes; secondly, the variations in budgetary activism may also reflect Congress's changing assessment of the Executive's handling of economic policy.

As has been shown, the dramatic increase in the congressional activity occurred in the period of Jaime Lusinchi and then continued through successive periods of Carlos Andrés Pérez, the transitional government of Ramón J. Velazquez, and the presidency of Rafael Caldera. There was a high level of congressional activity in this period (1986-1998), which in many cases took the form of important increases in the Executive budget. These budget changes in this period may be seen as a response to the changing perceptions of domestic political conditions. In particular, two political factors are important in explaining the change in pattern: firstly, the increase in party fragmentation; and secondly, the visible decay of tight party discipline.

In the 1980s and 1990s the major parties Acción Democrática and Copei and the organizations that represented specific interest, such as FEDECAMARAS in the business sector and CTV for unions, started to lose their capacity to aggregate, channel and manage the demands and interests of the sectors they supposedly represented. Moreover, trust in these institutions deteriorated, and within each of them internal discipline declined, leading members to question the leadership and reducing the margins for action and representativeness. This increased the number and differences among the actors involved, fractionalised the sectoral leadership, and generated more complex, costly and less predictable patterns of negotiation (Kornblith, 1995: 93). The power started to be fragmented, resulting in a systematic incapacity to form viable governing alliances. Party discipline and party-government coherency decayed, with serious implications for the ability of either the Executive or Congress to act effectively and with reasonable dispatch in public policy and particularly in budgetary policy.

In particular, party fragmentation rose very significantly at the end of the 1980s. The Venezuelan political system became more atomised with more parties represented in Congress; this fragmentation was an important factor in explaining the increase in congressional activity in Venezuela. Conventional wisdom argues that the lower the number of parties (e.g. the larger the government's majority party in Congress), the lower the transaction cost of redistributing and allocating budgetary resources for the president. The hypothesis comes from an extensive literature claiming that party fragmentation in the legislature tends to be inversely associated with the size of the president's party (Jones, 1995, Mainwaring & Scully 1995, Mainwaring & Shugart 1997, Linz & Valenzuela 1994). Thus, a president

with a smaller party contingent or facing many legislative parties would have to compromise and distribute patronage and "pork barrel" among the opposition in order to gather a legislative majority willing to pass his budget proposal.

A good example of this was the period of President Rafael Caldera during 1994 and 1999. In 1993 while Acción Democrática and Copei were harshly punished at the polls, they still controlled a majority of seats in Congress. The arithmetic of votes in Congress made it clear that Rafael Caldera could not create a legislative majority without either Acción Democrática or Copei. When President Caldera took office in February 1994, his party in the Chamber of Deputies, Convergencia commanded only 13% of the seats. His Legislative situation was quite difficult in terms of party support and was further complicated. Had he wanted to form a stable legislative majority, he would have had to make an enormous number of concessions to the largest parties in Congress. Thus, incentives for distribution of patronage and "pork" among opposition legislators were very clear in that period.

Equally, party discipline has been proposed as an important factor contributing to a president's legislative success: in this case, the proportion of a president's budget that wins approval in Congress without amendments. The Venezuelan democracy before the dramatic erosion of its parties at the end of the 1980s was a system with strong party discipline. Whereas, the period of low level of congressional activity between the 1970s and most of the 1980s was still characterised by oppositions and critiques and counter proposals. However the winning factors of an Acción Democrática and Copei majority and relatively strong party discipline ensured that the deals made between the Executive branch and the Congress were, for the most part, respected and the number of amendments of the budget very low. It would therefore be a mistake to infer from the relatively smooth passage of the President's budget in Congress that the budget was totally Executive-dominated during that period. Rather, the absence of conflict is explained in particular by two factors: first, a relatively disciplined Acción Democrática and Copei legislative majority that allowed for bargaining over the budget to be conducted in an intra-parties and less public manner; and second, the fact that most serious negotiation over the budget between legislators and the Executive branch normally took place prior to the formal submission of the budget to the Congress. Former Deputy Carmelo Lauría, who had witnessed most of the congressional budget procedures, describes the process in the 1970s and part of the 1980s vividly as follows:

> "…whatever was decided was usually carried out; when discussion was passed on to the plenary, they had already talked with his Deputy and, if there were any differences, then it was redefined by the corresponding Committee or these were presented in the parties' instances. However, once the decision had been made, the Deputies followed the party line**…"**

Finally, the variations in budgetary activism may also reflect Congress's changing assessment of the Executive's handling of economic policy. It is as if when Congress's confidence in the Executive is high, it makes fewer and minor changes in its budget. Larger and more frequent amendments to the Executive's budget request may signal the dissatisfaction of Congress with its performance and its determination to take a more active role in budget policy and in the economic policy in general (Kanter, 1972: 138). In some cases, triggered by disagreements over implementation of economic change, ruling party leaders turn against the Executive or, at least, against the economic authorities. The ruling party becomes a quasi-opposition force interested in blocking the Executive's agenda. A good example of this case was Venezuela between 1989 and 1992 during the implementation of the economic adjustment programme. The leadership of the governing party Acción Democrática was

strongly in opposition to the reforms (e.g. the tax reform)[29]. President Carlos Andrés Pérez tried to adopt controversial economic reforms by neglecting his own party and giving key economic posts to non-Acción Democrática members. Having few options to pursue a political career outside the party, Acción Democrática legislators staged a revolt against the Pérez government, which resulted in ministerial impeachments and concluded with the impeachment and ousting of Pérez himself in 1993. In economic policy, and in particular budgetary policy, the Pérez administration was an Acción Democrática government without "AD" support in Congress. Equally, his successor, as mentioned above, Rafael Caldera, failed to form a reliable and stable alliance of parties in Congress among other factors, because the dissatisfaction with the economic policies that the Government had implemented[30]. Thus, the policy of form consensus for budgetary policy in those periods was much more difficult.

In conclusion, the potential for governability in Venezuela was poor at the end of the 1980s. Compared to its highly governable past, society was more polarised and Congress was fragmented and divided. This period was generally characterised by the decline and eventual breakdown of cooperation and a volatile budget-making process. It was a period characterised by a higher number of fragmented and polarised actors in the policy-making process and, in general, higher transaction costs (Monaldi et al., 2004). Venezuela suffered the initiation of a period characterised by weaker Presidents, a decline in party discipline[31], increasing levels of party fragmentation, and electoral abstention. Consequently, it was a period characterised by weaker Presidents in the budget-making process and as result was characterised by confrontation between the Executive and the Congress over economic policy and in particular over budget policy.

In contrast, the first period from 1973 to 1988[32] was generally characterised by an institutionalised cooperative budget-making process with a low number of key players. This allowed the Presidents to conduct budget policy consultation with a very limited number of actors. It was, in general, a period of a highly centralised, disciplined and non-fragmented party system (closed list, no regional elections, etc), a low level of abstention, a marginalized legislature and controlled delegation to a predominant President with control over regional governors. The result is Executive branches with important powers in the budget-making process.

Budget amendments in the implementation stage

The formulation of the budget in the Executive and its approval in the Legislature together comprise only one part of the budget process. If one defines budgeting in the broader sense as the allocation of the resources available to the government, it is evident that several other decision-making processes

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[29] Other interesting cases in Latin America of opposition to reforms by the party in government were Haiti, Paraguay, and Ecuador in the mid 1990s (Corrales, 2002: 12).

[30] As mentioned before, in 1996 and 1998 Caldera's government employed the previous year's budget (*presupuesto reconducido*) because his budgets were not approved by Congress.

[31] Consistent with this analysis, Weldon (2002) argues that unified government, high discipline and strong presidential leadership over the party are necessary conditions to preserve the power of the President in budgetary issues. The resolution of the budget process, therefore, is influenced by these "metaconstitutional" mechanisms (institutional arrangements that are defined outside the Constitution and the laws), though they are highly dependent on legal institutions (such as the relation between no re-election and high discipline). When the three conditions hold it is possible to expect the President to have his budget passed without interference from Congress. If any of these conditions are lacking, then greater intervention by Congress is possible: greater incidence of not approving the budget, greater incidence of amendments to the budget, longer time allowed to examine and approve the budget, and so on.

[32] However, as was shown above, in strict budget terms it has been possible to verify a different pattern of Congressional activity since 1986.

must also be taken into account. These include supplementary budgets, rescissions of unspent funding (*insubsistencias*), transference of resources between budget chapters, and other budget amendments during the implementation stage of the budget[33]. In particular, supplementary budgets represent an additional point of budgetary interaction among the budget-making actors and patterns in the use of those appropriations may be related to regular appropriations[34]. In consequence, they may illuminate the budgetary bargaining between the Executive and the Congress and the influence of different interest groups. This section presents additional empirical evidence about this implementation phase of the budget[35].

In the Venezuelan case during the implementation stage the budget could be modified after approval by the Congress only but by initiative of the Executive. In consequence, supplementary budgets have been in the first instance of an Executive initiative; however, during the initiation, approval and execution of these, in one way or another, the two main actors (Executive and Congress) in the budget-making process have been involved.

However, the main question that arises in this sub-section is what was the percentage deviation between aggregate spending in the annual Venezuelan budget-making process and the total amount actually spent at the end of the budgetary year?

Table 8 provides data describing the difference between budget law and the "agreed+modifications budget" (including supplementary budgets and other budget amendments) between 1973-2004. The first observation to be made is that, with a few exceptions, the Budget Office has underestimated the final budget. The second is that the errors, particularly in years of oil booms, have been very high. The flows of amendments, especially supplementary budgets, appear to follow the level of oil prices, increasing during oil booms and dropping thereafter. It has proven more difficult to reduce supplementary budgets in years where revenue has been strong as a consequence of a typical boom in oil prices (e.g. 1974, 1980, 1984, 1989, 1996 and 2004). In many cases the Venezuelan experience has shown that high oil prices are the perfect excuse to increase public expenditure through supplementary budgets.

As a consequence of the oil boom and a testament to lack of planning, these supplementary budgets reached an astonishing 192% in 1974 and averaged 30% of the initial budgets during the next four years. Once President Carlos Andrés Pérez had permitted the 1974 budget to triple there was no

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33 During the implementation stage of the budget, new opportunities arise for the legislators and the Executive to deviate from the budget law and serve demands for additional spending. Two conflicting forces become important: the degree to which the budget law binds government's actions during the fiscal year, and the degree of flexibility to respond to unforeseen events. The binding force of the law depends on the ability to enact amendments during the fiscal year, and on the power of the finance minister to enforce the original budget. The degree of flexibility is related to the possibility of introducing supplementary budgets during the fiscal year, the ability to transfer resources between budget chapters, the existence of a budget reserve and the possibility of setting aside unused funds for future expenditures (carryover). According to these criteria, Venezuela's budget law was weakly binding and the budget implementation was inordinately flexible. There were no cash limits on spending ministries, the finance ministers and OCEPRE lacked power to block expenditures, budget changes and transfers of expenditures between chapters were routinely adopted, and carryover procedures were extremely flexible (Milesi-Ferreti, 1996; Von Hagen & Harden, 1995).

34 As will be explained below, it is clear in the Venezuelan case that supplemental spending has allowed governments to circumvent budgetary enforcement mechanisms and to deliberately under-fund programmes in the regular budget allocation process.

35 In particular, the amendments submitted and approved by the Executive in the implementation stage of the budget have been the following: rectifications (*rectificaciones*), elimination of credits (*insubsistencias*) and transfer to budget credits between items of no more than 5% of the total credits. Similarly, the amendments submitted by the Executive but approved by the Congress have been the following: transfer to budget credits between items of more than 5% of the total credits and supplementary budgets (AVPP, 1995: 283)

turning back. In the 1970s, the spending expanded throughout the bureaucracy, initial government goals and plans were deemed too modest, and public offices were actually asked to revise their budgets upward so that the government could spend more money more quickly. As a consequence, public offices increasingly relied on supplementary budgets, which had the additional advantage of being partially removed from congressional scrutiny.

This pattern did not change when presidential power shifted from Acción Democrática to Copei, despite President Herrera's pledge not to repeat the mistakes of the past in his period between 1978 and 1983. During the second oil boom, between 1979 and 1981, the actual spending was on average more than 25% of the original budget approved at the beginning of the year. In 1989, during the second Carlos Andrés Pérez government, supplementary budgets represented a whopping 74% of the initial budget and more than 9% of the GDP (table 8). This implies that the final budget had almost doubled as a consequence of multiple supplementary budgets. From this data it is evident that Congress routinely approved the Executive request for supplementary budgets. It can be inferred from this simple relationship that Congress found it politically difficult or inconvenient not to approve an Executive request whether or not it was made on an emergency basis.

Table 8. Difference between budget law and "agreed+modifications budget" as percentage of change, 1973-2004

Years	Budget Law	"Agreed+Modf." Budget	% of change
1973	13.819,4	14.833,8	7,3%
1974	14.548,7	42.482,7	192,0%
1975	41.395,7	39.747,3	-4,0%
1976	33.041,5	44.445,4	34,5%
1977	35.634,3	50.506,7	41,7%
1978	44.272,8	51.005,8	15,2%
1979	46.340,6	50.757,9	9,5%
1980	56.685,4	72.477,2	27,9%
1981	75.743,7	94.082,6	24,2%
1982	86.943,0	86.393,3	-0,6%
1983	76.381,9	78.863,2	3,2%
1984	77.040,9	103.138,2	33,9%
1985	102.843,6	112.772,4	9,7%
1986	122.283,2	123.631,1	1,1%
1987	158.018,9	181.121,5	14,6%
1988	185.122,4	186.753,0	0,9%
1989	183.305,5	319.477,0	74,3%
1990	443.718,1	577.056,1	30,1%
1991	713.429,6	801.257,1	12,3%
1992	863.224,0	1.002.246,7	16,1%
1993	1.105.791,7	1.100.718,1	-0,5%
1994	1.430.635,2	1.939.106,4	35,5%
1995	2.786.469,0	2.808.188,0	0,8%
1996	4.104.890,4	6.441.531,7	56,9%
1997	7.824.855,6	10.667.553,6	36,3%
1998	11.947.398,9	11.845.176,7	-0,9%
1999	13.696.059,0	14.557.817,0	6,3%
2000	17.878.137,2	23.553.560,8	31,7%

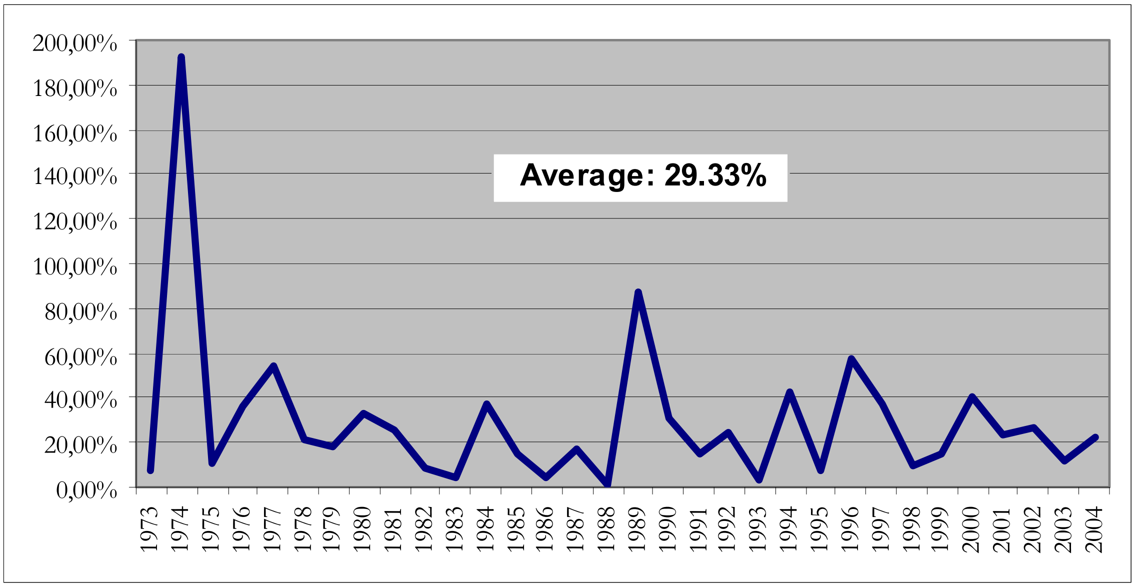
2001	23.214.303,0	28.079.215,2	21,0%
2002	26.443.129,3	31.687.452,4	19,8%
2003	41.600.426,6	41.613.124,5	0,03%
2004	49.950.883,6	60.505.058,4	21,1%

Note: “agreed+modifications budget/budget law.
Source: Own calculation based on National Budget data from 1973-2004.

In summary, the total spending level as a consequence of supplementary budgets was on average 29.3% higher than the budget law throughout the period 1973 to 2004 (figure 8). In all the years between 1973 and 2004 the budget increased as a consequence of the supplementary budgets that Congress approved. The Executive and Congress enacted more than 1900 supplementary budgets during the period 1973-2004. In each of the 30 years the Congress approved supplemental resources for the current year. Annual supplementary budgets funding ranged from a high of 2.900 million bolivars (164 supplementary budgets) in 1997 to a low of 4.4 million bolivars in 1975 (51 supplementary budgets). The highest levels of increase in the supplementary budgets as a percentage of the total budget occurred in 1974 (192%), 1989 (87%) and 1996 (57%), in response to the increase in oils price during those periods. The aggregate final spending level as a consequence of supplementary budgets was on average 29.3% higher than the budget law throughout the period 1973 to 2004, with the range varying between 0.8% for 1995 and 192% for 1974 (figure 3 & table 8). Therefore, a review of budget patterns in Venezuela indicates that actual spending was largely at variance with budget priorities established in the original budget law approved at the beginning of every year, contributing substantially to the fragmentation of the budgetary process and the weakening of spending control.

In the Venezuelan case, the legislation determined in principle that no actions or programmes that involved new spending could be carried out without specifying how they were to be financed; however in practice, the budget had loopholes thorough which expenditures were made without much planning. Congress often approved the initiation of activities without specifying the resources, stating vaguely that budgetary resources would finance them. In practical terms, when the Executive and the Congress agreed to undertake supplementary budgets to relieve financial pressure on certain public agencies, they usually suffered no political cost because they did not increase the income, reduce or cut programmes to finance the new spending. They just increased the deficit and financed this through debt or other extra-ordinary sources of fiscal income. Thus, supplementary budgets were designed to give governments the flexibility to respond to problems or priorities that may not have been anticipated during the regular budget cycle. However, given their high number and level throughout Venezuela’s budgetary history they have been a source of fiscal indiscipline, increasing spending, the budget deficit and, in consequence, the levels of debt.

Figure 3. Supplementary budgets as a percentage of total budget, 1973-2004



Source: Calculation based on National Budget data from 1973-2004.

Supplementary budgets by public office and agency

As the above analysis shows, a review of the actual spending patterns by public office and agency indicates that spending was largely at variance with budget priorities established in the original budget law approved at the beginning of every year. In particular, powerful ministers and public officers incurred in large number of supplementary budgets. The result was that the average deviation in actual allocation versus budgeting allocation was over 29% for the period between 1973 and 2004 (figure 3) with the range varying between 38.99% for the Ministry of Finance and 0.01% for the Attorney's Office (table 9).

Table 9 shows the proportion of supplementary budgets by public agency and office as a percentage of the total submitted to the Congress every year for the period 1973-2004. The Columns show the average of all supplementary budgets by periods. As can be seen from the data, some sectors have systematically increased their allocation in the budgetary process in Congress. For example, the Ministry of Finance was the component with the highest average variation. This ministry increased its budget on average more than 38.99% for the period. This level was associated fundamentally with supplementary budgets allocated to the ministry for the payments of internal and external debt. As has been already been explained, when it was necessary to increase some other item of the budget, one of the classical solutions was a reduction in the allocation of the debt (underestimation), redistributing from this item to another in which the Deputies had some political interest and then, during the fiscal year, the Congress decreed supplementary budgets to correct the deficit.

Table 9. Supplementary budgets by public office as a percentage of the total, 1973-2004

Public offices	%73-98	%99-04	%73-04
National Electoral Council (1977-2004)	0.85%	1.74%	1.05%
Ministry of Industry (1977-2004)	1.57%	0.71%	1.45%
Presidency Office (1978-2004)	1.84%	0.32%	1.51%
Congress (1977-2004)	0.13%	0.32%	0.17%
Ministry of Environment (1978-2004)	4.56%	1.42%	3.89%
Ministry of Transport & Communications (1978-2004)	9.18%	6.55%	7.84%
Supreme Council of Justice	0.03%	1.50%	0.31%
Ministry of Urban Development (1978-1999)	4.24%	2.39%	5.12%
Ministry of Agriculture (1973-1999, 2003-2004)	5.03%	2.88%	4.74%
Public Prosecutor's Office.	0.01%	0.19%	0.12%
National Comptroller	0.03%	0.04%	0.03%
Ministry of Family (1973-1999)	1.44%	0.51%	0.66%
Ministry of Justice (1973-1999)	0.33%	0.53%	0.34%
Ministry of Defence	4.47%	4.43%	4.46%
Judiciary Council (1977-2000)	0.51%	0.06%	0.45%
Attorney's Office (Procuraduría)	0.12%	0.03%	0.01%
Ministry of Internal Affairs	7.28%	12.02%	8.16%
Ministry of Education	14.56%	14.13%	14.48%
Ministry of Foreign Affairs	0.46%	0.26%	0.42%
Ministry of Finance	38.91%	39.36%	38.99%
Ministry of Health	4.63%	4.67%	4.63%
Ministry of Labour	0.93%	5.12%	1.71%
Ministry of Energy & Mines	0.13%	0.71%	0.66%
Ministry of Youth (1978-1987)	0.67%		0.39%
Ministry of Information and Tourism (1978-1985)	0.40%		0.40%
Ministry of planning and development (2000-2004)		1.05%	1.05%
Ministry of science and technology (2000-2004)		0.43%	0.43%
Peoples defender (2001-2004)		0.18%	0.03%
Vice-presidency Office. (2001-2004)		0.01%	0.02%
Ministry of universitary education (2003-2004)		6.49%	6.49%
Ministry of communication and information (2003-2004)		1.51%	1.51%
Moral Power (2004)		0.02%	0.02%
National Audit Office (2004)		0.01%	0.01%
Rectifications (1999-2004)		0.00%	0.00%
Total (1999-2004)		100.00%	100.00%
Average for the period	**4.09%**	**3.54%**	**3.38%**

Source: Calculation based on National Budget data from 1973-2004.

As pointed out in the interview with the former Christian Democratic Deputy and former president of the Finance Committee Haydée Castillo: "Who can deny a supplementary budget for payments of debt if it was compulsory?". In the same line of argument, the former Acción Democrática Deputy and former Ministry and president of the Finance Committee Carmelo Lauría explains:

> "…Basically debt [the budget item usually cut]. First, because it was the easiest to carry out, remember what you could take from other items whenever there was an expenditure underestimation, because you could not deduct it from the payroll, remember, this is a 96% inflexible budget…That is why you will find indebtedness in the other ministries; those items that you thought were not necessary and that the government was including for political reasons, you changed"

In terms of the economic components of the budget, tactical cuts in the budget approval tended to fall heavily on non-staff costs, thereby compounding the effect on the operation of government services. Another likely candidate was capital spending. Outlays on salaries, however, were rarely touched. Then, as was mentioned above, during the implementation stage of the budget Congress decreed supplementary resources to correct the deficit. In particular, in the 1970s, supplementary budgets were decreed to cover spending evenly between capital and current spending, and in the 1980s and 1990s were overwhelmingly associated with current spending[36]. An important amount of money went to salaries, transfers for the decentralised public administration, and payments of internal and external debt. Thus, most of the supplementary budgets in the study period fell into three categories: supplementary pay to cover the cost of government salaries, including pensioners, whose amounts were either not known or were underestimated at the time when the budget was enacted; current transfers to the public agencies and decentralised offices; and payments of debt.

After the Ministry of Finance, the second largest recipient of supplementary budgets was the Ministry of Education. This ministry increased its budget in every year with almost 5 supplementary budgets per year and 14.5% of supplemental spending during 1973 and 2004. Only in 1997 were more than 701.744 million bolivars approved in Congress for this sector. The resources allocated to this Ministry were used to a significant degree to finance the requests from the national public universities

Not surprisingly, the Ministry of internal affairs and Ministry of Transport and Communication (MTC) also increased its budgets and took more than 8.2% and 7.8% respectively of the total supplemental funds. Even though the MTC correlation between the number and amount of the supplementary budgets was negative (the increase in the total budget of the ministry was 2.7%), MTC received a substantial number of supplemental budgets in almost every year of the period, totalling on average 6 per year. Other offices that systematically increased their share of the total budget through the supplementary budgets were the Ministry of Agriculture (4.7%), the Ministry of Defence (4.5%) and the Ministry of the Environment (3.9%). Of all the supplementary budgets enacted between 1973 and 2004, more than two-thirds fell under the control of the Finance, Education, Internal Affairs and Transport Ministries. Likewise, almost one Fifth of the total supplementary resources fell within the sectors of environment, agriculture, health and social assistance and defence. Thus, this increase in the use of supplementary budgets confirms the fact that those allocations were political decisions that reflected the willingness of the Executive and Congress to undertake additional allocations for some programmes or sectors of interest (Wleizen, 1993: 70).

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[36] Current expenditures were the item in the economic classification of the budget that showed the greatest increase in the period 1974-1999 (Puente, 2005).

Given this record, it is unsurprising that the governments regarded education, health, agriculture and defence as being among their biggest budget headaches; however, virtually throughout the period of this study their attempts to reduce the number of supplemental allocations to these sectors were stymied by well-organised interest groups. For example, overrepresentation of the rural sectors in the Legislature and particularly within the Acción Democrática party multiplied the effectiveness of political pressures in the agricultural area.[37] The military sector as shown by the data and acknowledged by Ramon Jose Medina, a Copei former member of the Finance Committee, was also very influential in the implementation stage of the budget:

> "The military sector in Venezuela has carried great weight in the public credit. If you evaluate the programs financed in military matters, you will observe that the majority does not have support with regard to needs or demands. Hence, the impression that the regime does not offer many changes comes from the fact that the fight is against their intention to eliminate the controls that the executive had via the Congress"

Venezuelan governments have implemented a symptomatic increase in the granting of supplementary budgets by making use of different strategies. One of the devices often resorted to public agencies was to deliberately spend their allocated funds before the end of a budgetary year and then return to Congress for additional funding. As Carmelo Lauría points out:

> "Here you do not authorize expenditures for corporations or museums and carry on just the same and not only that, including culture… there is a habit where they ask for funds and you do not provide these funds, the institutions keep their budgets convinced that the government owes them the same."

In conclusion, the analysis of this section indicates that supplementary budgets have been used routinely in the last thirty years as instruments to maintain the budgetary status quo and preserve the budget allocations of some important groups in the Venezuelan society as well as compensating those sectors for low levels of funding in the approval-stage process (Wlezien, 1993: 70).

Other factors may also determine the need for supplemental allocations during the implementation stage, reflecting several political and economic influences. Inflation, for example, when higher than anticipated, may create the need for supplementary budgets for different programmes and items. Budget procedure evolves on the assumption that the purchasing power of money will remain stable; however, if the rate at which prices rise is uncertain, supplemental funds may be needed. In particular, after 1983 following the first devaluation inflation appeared as a phenomenon in the Venezuelan economy, leading to the difficulty of making reliable projections. Inflation affects both expenditures and revenues and makes inapplicable some traditional methods of forecasting and control. Governments, moreover, are reluctant to publicise their best guesses about the future rate of inflation because they do not want to open themselves up to criticism and because such official forecasts may become partially self-fulfilling prophecies. At the same time, uncertainty about likely price levels can "excuse" and thereby perpetuate a lax attitude to budget preparation: when the budget is subsequently executed, the results may also include wasted administrative efforts spent switching resources from one budget line to another; loss of macroeconomic control over the total; poor allocation of resources among programmes; expenditure arrears and a fundamentally excessive use of supplementary budgets. Thus, the formulation and execution of government budgets is greatly complicated by inflation. When

[37] Despite not being a powerful sector in the overall allocation of public resources agriculture sector was very influential in the allocation of supplementary budgets especially during the 1970s.

inflation is unexpectedly high, the automatic cost of living adjustment across a range of programmes increases benefits. To the extent that transfers from other accounts or *insubsistencias* cannot absorb those costs, supplemental spending may be required[38].

Moreover, many Venezuelan governments have attempted to provide economic stimulus during recession periods through supplementary budgets[39]. For example, Luis Herrera Campíns (Copei) faced an especially difficult situation because his was the first government to suffer the consequences of negative economic growth and inflation after an initial reprieve of the 1980 oil boom. In addition, he confronted persistent opposition from Acción Democrática dominated Confederation of Venezuelan Workers (CTV), as well as from a divided Congress that his party did not control. To cope with these pressures, President Herrera pushed government spending to new heights, despite his repeated promises to rein in expenditures, and he resorted to further foreign borrowing (Karl, 1994: 44). This factor explains in high proportion the difference between the budget law and the executed budget for the years 1980 and 1981 (27.9% and 24.2% respectively). Similarly, in 1989 in the Carlos Andrés Pérez government, in the middle of the economic adjustment process and the associated recession, all the incentives for the Government to stimulate aggregate demand and the economy through public expenditure were also created. President Pérez's economic stimulus programmes are another example of how supplementary budgets can be used. The 139.000 million bolivars in supplementary funding contained in that legislation was partially justified in a government that was looking for economic stimulus in a year of huge economic contraction. Likewise, the period of Jaime Lusinchi was characterised by the intention of this government to create an illusion of harmony in the economy, and the economic stimulus that supplementary budgets created was one of the strategies used. Furthermore, the Gulf War in 1989 spurred high expectations concerning the level of fiscal revenues, making it even more difficult for the Carlos Andrés Pérez government to impose a greater level of austerity in its public finances and its level of supplementary budgets.

In the same way the very politically rewarded annual increases in the salaries of government employees have been in many cases financed by supplementary budgets. These increases have been usually announced by Presidents in May (Workers Day), and follow recommendations from the Ministry of Labour. Finance Ministries and OCEPRE's directors have many times taken the lead in arguing that recommendations should not be implemented in full; however, again their positions have been considerably weakened in the years when it was possible to provide large supplementary budgets.

It is clear that in the Venezuelan case the spending-control problem stems in an important proportion from the use of supplemental funding. Unpenalised overspending and subsequent requests for additional appropriations have undermined budget constraints. The binding ceilings in the budget must always be raised in order to accommodate the multiple supplementary budgets requested, disrupting the discipline of the budget process. Thus, the routine use of supplementary budgets has

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[38] The Congress and the Executive traditionally sought to offset new supplementary budget funding by rescinding amounts of unspent funding in other areas of the budget. Rescissions could reduce the budgetary impact of discretionary supplemental allocations. For example, in 1995 the level of "insubsistencias" was almost equal to the new approved supplementary budgets. However, data on the estimated amounts of rescinded for the period 1973-2004 suggest that in only two years (1975 and 1995) did the rescissions offset the level of supplementary budgets decreed during that period. For the other years between 1973 and 2004, these rescissions did not produce high enough outlay savings to fully offset the supplementary spending.

[39] After deficit financing became possible, this economic stimulation was provided in many cases by increasing the bond sale above the estimates in the initial budget. In some years, more than 60% of the total supplementary budget was financed with public debt.

contributed to the erosion of budgetary discipline and congressional fiscal controls and has pushed up spending.

The high number and level of supplementary budgets approved during the period 1973-2004 have been an important source of fiscal indiscipline and a source of power of specific interest groups in the Executive-Congress budget decision process. In particular, the analysis in this study indicates that supplemental funds have been routinely used as instruments to maintain the budgetary status quo and preserve the budget allocations of some important groups in the Venezuelan society, as well as compensating those sectors for low levels of funding in the approval stage process. Therefore, a review of budget patterns indicates that actual spending was largely at variance with budget priorities established in the original budget law approved at the beginning of every year, contributing substantially to the fragmentation of the budgetary process and the weakening of spending control and fiscal discipline.

The Venezuelan experience shows that ensuring that government's budget proposals reflect prudent fiscal behaviour and clear objectives is not particularly useful if Congress can modify the size or the composition of the budget with relative ease, or if at the implementation stage the discretionary margins are such that systematic divergences emerge between ex-ante budgeted expenditures and ex-post actual ones. In fact, the empirical evidence has shown that the un-penalised overspending and subsequent requests for additional resources have strongly undermined the hardness of budget constraint. Budget laws have not been very binding on some expenditure, and changes in the composition of spending have been carried out relatively easily. This has resulted in soft budget constraints, especially for some areas of spending, and in almost constant bargaining over the budget.

Executive and Legislative interaction coefficients

Additional evidence about the patterns the Executive and legislative interaction in the budget making process can be shown. Following the methodology of Abuelafia et al., 2005 this sub-section estimates the relative magnitude of changes in spending composition introduced in different stages of the budget process. The following coefficients were calculated:

[1] Stage 1: $$C_{BL} = \frac{\sum_{i=1}^{N} |B_i - L_i|}{2}, \text{ for each year}$$

[2] Stage 2: $$C_{LV} = \frac{\sum_{i=1}^{N} |L_i - V_i|}{2}, \text{ for each year}$$

[3] Stage 3: $$C_{VD} = \frac{\sum_{i=1}^{N} |V_i - D_i|}{2}, \text{ for each year}$$

Where:

B_i: is the participation of item *i* in total spending presented in the Executive budget proposal.

L_i: is the participation of item *i* in total spending approved in the budget law.

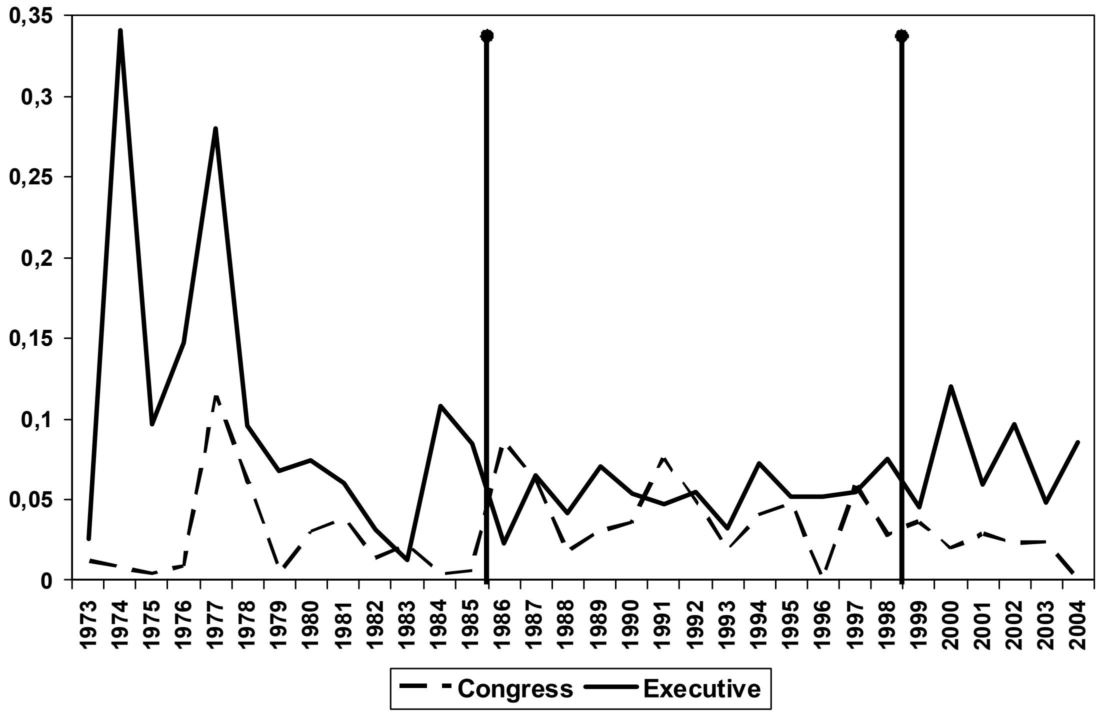
V_i: is the participation of item *i* in the total of effective credit.

D_i: is the participation of item *i* in the total of executed expenditure.

The coefficients C_{BL} and C_{LV} represent the yearly changes in the composition of spending in the approval and execution phases respectively. C_{VD} on the other hand is a crude indicator of budget efficiency, since it measures the extent to which planned expenditures are actually executed.

The results for the coefficients are presented in Figure 4 and in 5. Only in four years (1984, 1986, 1991 and 1997) does Congress play a more important role than the Executive in defining budget outcomes. This is once again consistent with the argument that the Executive branch is the leading actor in the budget-making process, however budget allocations and particularly budget reallocations are also the product of legislators' power.

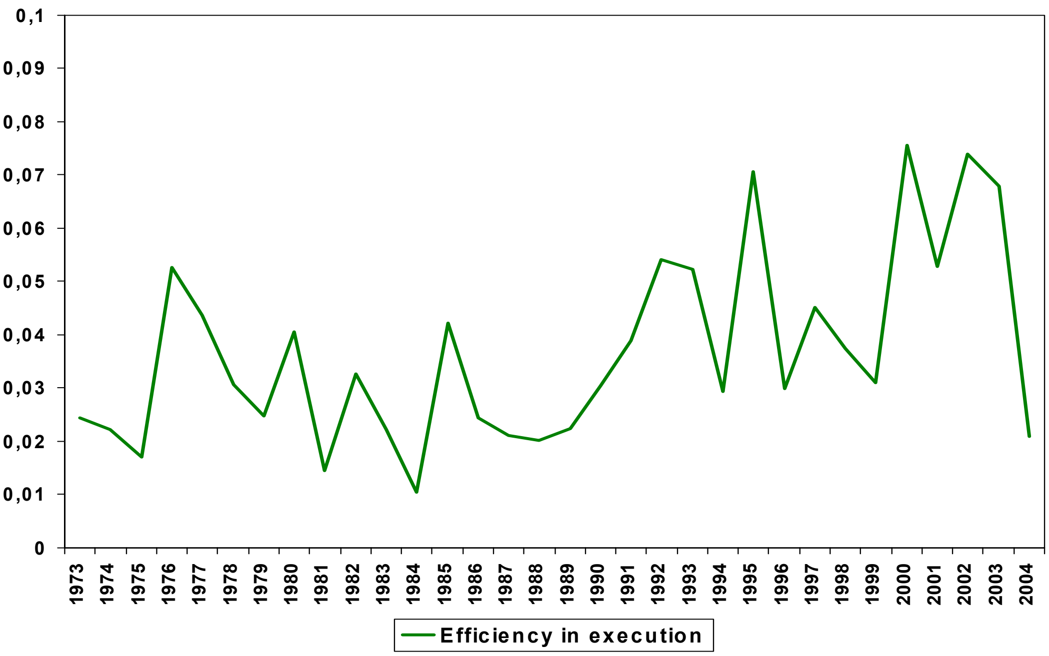
As shown above, important negotiations do go on in Congress, even if most of the action occurs at the Executive level. Ministers, public managers and interest groups who failed to include their budget needs in the planning phase in many cases influence reallocations in the approval and implementation phase of the budget. Furthermore, legislators attempt to increase pork for their districts and groups or sectors of interest.



Source: Authors' own calculation

Equally, consistent with the analysis already made in this paper, the coefficients presented serves to identify two different patterns of congressional activity in the period 1973-2004: two periods (1973-1983 and 1999-2004) characterised by a relatively low level of congressional involvement and a clear power of the Executive in the budget-making process. A third period (1984-1998) characterised by a high level of Congressional involvement with a more balanced sharing of power between the two main actor, including four years where even the Congress play relatively a more important role than the Executive in defining budget outcomes. Figure 4. Changes in the composition of spending by stage. 1973-2004

Figure 5. Changes in the composition of spending by stage (efficiency in execution). 1973-2004



Source: Authors' own calculation

Following Jones (2001), it is important to mention that the fact Congress does not make significant changes in the budget in some years is not sufficient evidence of a weak role. It could be that legislators negotiate with the Executive in the implementation phase of the budget or that the Executive tailors its proposal to fit the preferences of Congress so as to ensure its approval (Abuelafia, et al., 2005).

VI. Econometric Evidence

Previous section stated the evolution of the relative strength between the Executive branch and the Congress. The aim of this section is fundamentally to address the question of how this relative strength between the Executive and Congress, controlling by some other variables, affects the fiscal performance of Venezuela.

In order to measure fiscal performance, the variables selected are both, primary and total balance as a share of GDP. In particular, primary balance allows controlling the effect of previous deficits on current fiscal balance. This is very relevant in a country such as Venezuela in which high debt levels is a structural characteristic of the public finances (Garcia, et al, 1997; Puente; 2004 and Rios, 2003).

The independent variables are: i) the effect of Executive and Congress relative power on fiscal performance. The control variables are: i) constrains imposed by oil income, ii) the possibility that policy makers respond to electoral events, meaning the existence of a "political budget cycle" (Shi & Svensson 2003) and iii) the effect of macroeconomic adjustment programmes over fiscal results.

The proposed model, originally estimated by OLS is[40]:

$$FP = \alpha + \beta_1 OFI + \beta_2 Elec + \beta_3 Exec + \beta_4 Leg + \beta_5 Adjust + \mu i \qquad (1)^{41}$$

Where:

FP: Fiscal performance.
OFI: Total fiscal income
Elec: Dummy variable that takes the value 1 for each electoral year and zero otherwise
Exec: Relative power the Executive branch has in the budget allocations process.
Leg: Relative power that the Legislative has in the budget allocations process
Adjust: Dummy variable that takes the value 1 for each year in which a macroeconomic adjustment program has been implemented.

Findings

The main findings from the regression (table 10) are the following:

A relative stronger Executive power is positively associated with a better fiscal performance

As was pointed out in a previous section (Executive and Legislative interaction coefficients), in the majority of years under the period studied, Executive branch in Venezuela has displayed a relative higher degree of power in the budget reallocation process.

According to the results shown in Table 10, one per cent increase in the Executive power index is linear and positively associated with an average improvement of 0.2% in the primary balance and 0.29% in the global fiscal balance.

This evidence is consistent with the result of previous studies for industrialized countries (Alesina et al. 1997; Alesina and Perotti 1995; Roubini and Sachs, 1989) as well as for Latin American nations (Amorin Nieto and Borsani; 2003). All these works have found that the greater the power of the Executive the lower the level of fiscal deficits.

The relative power of Congress in the budget reallocation process is correlated with a worse fiscal result.

Consistent with the previous section, during the period between 1984 and 1999, the relative power of the Venezuelan Congress increased. In fact, during this period, the number of reallocations carried out by congressmen shows a significant growth.

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[40] A robust estimation was used, which consists in computing the Huber-White variance-covariance matrix. As this procedure is a particular case of generalized least squared, the reader must remember that typical R^2 is only full valid as a measure of model fitness in the ordinary least squared method (Davidson and MacKinnon; 2003).

[41] The econometric evidence in this study follows a standard approach with a proposed linear specification. Regressions in which both the dependent and the explanatory variables have no unit roots are run in order to avoid the classical problem created by the use of non-stationary variables and the possibility of incurring in spurious regression.

According to the model, a relative increase in congressional power in the budget reallocation process has had a negative impact on the fiscal balance. Actually, the results suggest that a greater coefficient (1%) is associated with an increase in the average primary deficit of 0.5% and 0.6% in case of the global deficit.

Table 10. Political and Economic determinants of the Venezuela's fiscal performance (1973-2004)[a]

	Period under study 1973-2004	
	Dependent variables	
	Primary balance	Total fiscal balance
Independent variables[42]		
Constant	0.0016632	-.0266442
	(0.11)	(1.90)
Exports (cyclical component)	5.76E-6	5.75E-6
	(2.84)*	(2.74)**
Executive Strength	0.20183	0.29234
	(1.63)***	(2.58)**
Legislative Strength	-0.52015	-0.60717
	(-2.17)**	(-2.63)**
Elections	-0.029346	-0.0266
	(-2.08)**	(-1.90)***
Macroeconomic Adjustment	-0.029364	0.03632
Programme (MAP)	(1.70)***	(1.70)***
$\overline{R}^2$:	0.56	0.57

[a] The information in brackets is the T-statistic

* Statistical significance to the level of 1%

** Statistical significance to the level of 5%

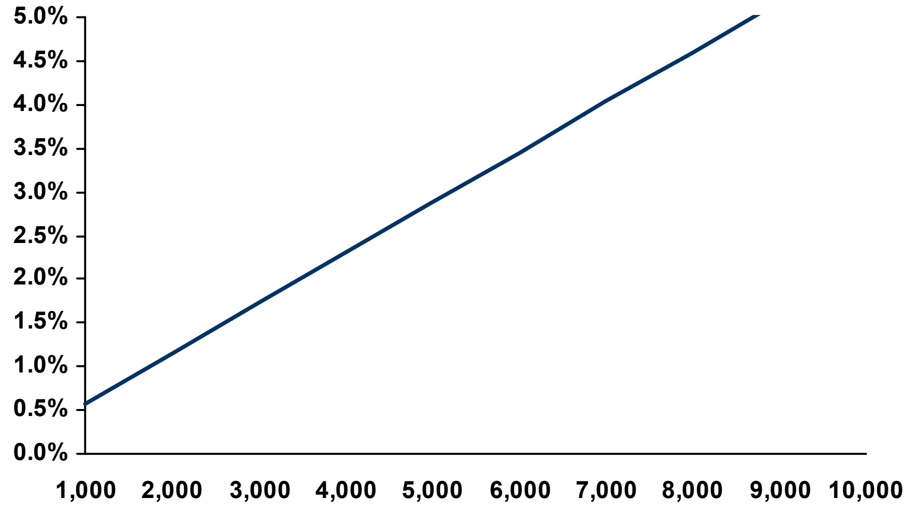
*** Statistical significance to the level of 10%

Unexpected oil fiscal income has a significant effect on fiscal performance.

The first control variable included in the model shows that oil shocks or unexpected increases have a significant impact on the fiscal balance. It was found that, in both, primary and global fiscal balance, an unexpected increase of one billion dollars improves the fiscal performance on 0.575% of GDP. Figure 6 shows graphically this impact.

[42] Fiscal performance was computed in units (meaning that 5.75% was introduced as 0.0575), total exports were measured in millions of current dollars, and Executive and Legislative power index calculated based on Abuelafia, et al (2005), were introduced in units as well. This is relevant just for reading the coefficient of some variables, but also to facilitate the explanations of the results in this section.

Figure 6. Relationship between total unexpected exports (as a proxy of unexpected oil fiscal income) and fiscal performance



Source: Author's own elaboration.

There evidence that support the political budget cycle

Evidence was found that supports the existence of a political budget cycle in Venezuela. Based on the results, on average each presidential election year is negatively associated with the fiscal performance. The results suggest that on average, fiscal performance is worse, around (2.5% - 3.0%), as a share of the GDP (See table 10)[43]

Macroeconomic adjustment programmes have an effect on fiscal balance.

Finally, a second dummy variable was included to capture the effect that the implementation of a macroeconomic adjustment programmes has on fiscal performance[44]. The model indicates that macroeconomic adjustment programmes improves, on average, primary balance around 2.9% and 3.3% in case of the global fiscal balance.

[43] The 1968 election was use as the base year.

[44] Even though, there are several episodes of macroeconomic adjustments (1979, 1984, 1989, 1994, 1996 and 2002) only those associated with financial international organizations, and in particular with IMF, were taken into account. That is reason why only 1989 and 1996 where chosen as years of macroeconomic adjustment programmes.

Box. 3. Methodological issues

This box discusses some of the reason behind the selection of a specific proxy variable for the oil fiscal income, as well as other economic variables in the econometric model.

On the explanatory variables side, several economic variables were implemented as controls. In particular, a regression was run with the inflation rate, oil price, total exports and unemployment rate. Inflation and unemployment rates were disregarded due to statistical meaningless.

Also, oil price was discarded because its inclusion as a proxy of fiscal income implied a source of endogeneity. In fact, oil fiscal income is composed by the price and the amount of barrels exported. During some periods, prices are highly correlated with the amount of barrels exported by Venezuela (particularly, during the 1980s and the mid-1990s).

In this sense, if a regression is run in which oil fiscal income is an explanatory variable and only oil price is included as a proxy of fiscal oil income, endogeneity is introduced in that regression, because oil price (explanatory variable) will be correlated with the perturbation term (in which the amount of barrels would be present).

Having discarded other controls, total exports were chosen as a proxy of fiscal income.[45] Once selected this variable, included only its cyclical component is included for both econometric and economic reasons. On the economics side, under rational expectations what causes real effects in the fiscal result are unexpected changes on variables. Following a standard procedure in the literature, the expected component was approximated applying the Hodrick - Prescott filter to the levels of the original variables and then the cyclical (unexpected) component was computed as the deviation of the original variable from the expected component.

On the econometrics side, the cyclical component of the total exports is stationary which avoids the possibility of spurious regression.

Conclusions

The main conclusions of this study are:

Firstly, from the general policymaking as well as budget-making perspective, three distinctive sub-periods within the years 1974-2004 were identified from both a qualitative as well as quantitative approach, displaying the following main characteristics:

> First Period (1974-1988) - Strong Presidential power within a cooperative system strongly influenced by a corporative arrangement in a limited political competitive context.
>
> Second Period (1989-1998) - Weakened Presidential power and stronger Congress within a non-cooperative system and a fragmented political context.
>
> Third Period (1999-2004) - Constitutional and informally powerful President with no political competition.

[45] Total oil exports would have been a more accurate proxy variable. Unfortunately it is only available since 1989.

Secondly, in general the Executive branch has been the leading actor in the budget-making process. The Executive has a number of bargaining advantages over Congress during the process. However, budget allocations have also been the product of legislators' pursuit of (re) election and power, as well as the demand of interest groups.

In particular, Congress has altered the overall composition of spending proposed by the Executive in the approval stage of the budget. Cross-sectional variations in congressional activity support the view that legislature increases in the Executive's budget were concentrated in a group of public offices and ministries. One may conclude from these results that congressional activity and, inferentially, congressional interest was concentrated in those sectors. Certain budget categories appeared to attract more congressional interest than others. Thus, the Legislative, even without altering the overall spending levels, pressed for redistribution of appropriations across programmes, areas and public offices benefiting specific interest groups.

Likewise, the high number and level of supplementary budgets approved during the period 1973-2004 have been an important source of fiscal indiscipline and a source of power of specific interest groups in the Executive-Congress budget decision process. In particular, the evidence indicates that supplemental funds have been routinely used as instruments to maintain the budgetary status quo and preserve the budget allocations of some important groups in the Venezuelan society, as well as compensating those sectors for low levels of funding in the approval stage process. Therefore, a review of budget patterns indicates that actual spending was largely at variance with budget priorities established in the original budget law approved at the beginning of every year, contributing substantially to the fragmentation of the budgetary process and the weakening of spending control and fiscal discipline.

Thirdly, besides fundamental economic variables, such as oil income, macroeconomic adjustment programmes; it is found that political variables such as electoral year, the power of the Executive vis-à-vis Legislative among others, are important determinants of budget (re) allocations and fiscal performance. In particular, the main findings from the econometric work about the main political and economic determinants of fiscal performance are the following:

(1) A relative stronger Executive power is positively associated with a better fiscal performance.

(2) The relative power of Congress in the budget reallocation process is correlated with a worse fiscal result. Therefore, this trade-off between representativeness and sustainability could be assumed as one of the intrinsic costs of democracy.

(3) Unexpected oil fiscal income has a significant effect on fiscal performance.

(4) On average each presidential election year is negatively associated with the fiscal performance.

(5) Macroeconomic adjustment programmes have an effect on fiscal balance.

Fourthly, as has been shown by the political economy literature, political institutions affect the 'rules of the game' under which different actors interact, by placing constraints on the whole budgetary process and distributing power and responsibilities among different actors.

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Annex 1. The Macroeconomic Stabilization Fund

In November of 1998, the government approved a Macroeconomic Stabilization Fund (Fondo de Estabilización Macroeconómica or FEM) with the objective of smoothing out the effects of oil export price fluctuations on public finances. The rules of the FEM apply to PDVSA, the central government and local administrations. This mechanism intends to be a sort of "black box" where unexpected oil windfall are saved and used during periods when fiscal oil revenues are low or below estimates, therefore preventing a pro-cyclical fiscal policy. However, since its creation, the FEM has been modified several times to allow investment in government projects and more recently to stop saving during oil booms. Of course, this changes has altered substantially the spirit of this fiscal rule, making it basically useless.

During the oil boom of the 70s, during the first Carlos Andrés Pérez's government a similar mechanism called FIV (Fondo de Inversiones de Venezuela) was implemented, but its main objective was to invest the oil windfall in projects and public enterprises of national interest. At the beginning of the 90s, during the second government of Carlos Andrés Perez, an oil contingency fund was designed and presented to Congress for approval. The decision to create the fund was approve by the Economic Cabinet in October 1991, but it was not approve by Congress when it was submitted as part of the new budget law in October 1992. The main reason behind this was that the FEM law was presented together with a new central bank chapter and during the political negotiations between congress and the executive, they agreed to pass the central bank law but not the FEM. Additionally, legislators at the time were not convinced of the necessity of saving excess oil revenues. It is interesting to notice that the FEM law approved by Congress in 1998 was during a period of low oil prices which made it easier for legislators to pass the law because they did not foresee any significant accumulations in the near future.

It is illustrative of the lack and weaknesses of fiscal rules in Venezuela to describe the evolution and modifications of the FEM since its creation in 1998. Originally, the FEM was supposed to operate on an automatic basis. Oil windfalls or shortfalls were determined comparing current oil revenues with a reference value calculated as a five years moving average of oil revenues. Resources could be withdrawn only for debt amortizations if oil revenues in a given year felt below the reference value or if resources in the FEM exceeded eighty percent of the five year moving average of oil export revenues. FEM resources are administrated in a similar fashion to the international reserves of the central bank and are maintained abroad. Funds withdrawn from the FEM are sold to the central bank and deposited in local currency in the accounts of the respective public sector entity (central government, local governments or PDVSA).

In 1999 a fixed reference value of $9 per barrel was established, setting the resources to be deposited in the FEM at 50% of the excess over the reference value. This modification also allowed the President to withdraw funds with Congress authorization. However, the rules for adding resources to the fund were never issued, which undermined the mechanism due to lack of transparency and uncertainty about the norms governing the fund operations. In 2001 a new modification to the law exempted the central government and PDVSA from depositing in the FEM in the last three months of 2001 and all 2002. Later that year another reform of the law also exempted these entities from adding funds to the FEM during 2003.

In 2003 Congress modified the rules of resources accumulation of the FEM. Contributions to the fund are supposed to be made when oil revenues are above a three year average. Similarly to the original law, 50% of the excess over the reference value should be deposited in the FEM. These

changes also established that the central government and PDVSA were exempted from depositing in the fund during 2004. Clearly the rules of the FEM have not been implemented consistently and successive changes have eroded the stabilization power of the fiscal rule. This has caused lost of credibility in the fiscal authority and probably will make more difficult to implement similar rules in the future.

Annex 2

Representation in Congress (1974-2004)

				Parties in Remaining Seats in Congress							
	Government Party	Popular vote in the Presidential election by Govern Party	Seats in the Chamber of Deputies	AD	COPEI	Causa R	Conv	MAS	MVR	PV	FJAC (AD,COPEI, PV,PJ)
Carlos Andrés Pérez (AD) 1974-1979	AD	49%	51%	Gov Party	32%	-	-	-	-	-	-
Luis Herrara Campíns (COPEI) 1979-1984	COPEI	45%	42%	42%	Gov Party	-	-	-	-	-	-
Jaime Lusinchi (AD) 1984-1989	AD	55%	56%	Gov Party	30%	-	-	-	-	-	-
Carlos Andrés Pérez (AD) 1989-1992	AD	53%	48%	Gov Party	33%	-	-	-	-	-	-
Rafael Caldera (Convergencia) 1994-1999	Convergencia	17% + Coalition	13% + Coalition	27%	26%	20%	Gov Party	11%	-	-	-
Hugo Chavez (MVR) 1998-2000	MVR	40%	22%	30%	14%	-	-	8%	Gov Party	10%	-
Hugo Chavez (MVR) 2000-2005	MVR	48%	56%	-	-	-	-	4%	Gov Party	-	30%

Source: CNE and own calculations